

2566  
No. 12143

---

United States  
Court of Appeals  
for the Ninth Circuit

---

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

---

Transcript of Record

---

Petition to Review a Decision of The Tax Court  
of the United States

FILED

APR 4 - 1949

PAUL P. O'BRIEN,  
CLERK



No. 12143

---

---

United States  
**Court of Appeals**  
for the Ninth Circuit

---

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

---

**Transcript of Record**

---

Petition to Review a Decision of The Tax Court  
of the United States

---

---



## INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Affidavit in Support of Request Extending Time to File Record on Review:	
December 15, 1947 .....	80
January 1, 1949 .....	221
Appearances .....	1
Amendment to Petition .....	21
Answer .....	20
Answer to Amendment of Petition .....	23
Certificate of Clerk to Transcript of Record...	89
Court Orders Extending Time to File Record on Review:	
February 1, 1948 .....	81
April 15, 1948 .....	82
July 15, 1948 .....	83
October 15, 1948 .....	83
December 15, 1948 .....	84
January 1, 1949 .....	85
Decision .....	66
Designation of Contents of Record on Review..	85
Docket Entries .....	66
Memorandum Findings of Fact and Opinion..	47

	PAGE
Motion to Correct Decision (Denied).....	67
Motion for Order for Consideration of Exhibits in Original Form (USCA) .....	228
Motion for Rehearing De Novo (Denied).....	61
Notice of Filing Petition for Review.....	78
Order for Consideration of Original Exhibits (USCA) .....	228
Petition .....	5
Exhibit A—Notice of Deficiency .....	11
Petition for Review .....	69
Statement of Points and Designation of Record (USCA) .....	223
Stipulation of Facts .....	24
Exhibit 2-B—Walts Inc. Balance Sheet, Dec. 31, 1941 .....	36
Exhibit 3-C—Walts Inc. Profit and Loss Statement, Dec. 31, 1941 .....	37
Exhibit 4-D—Walts Inc. Profit and Loss Statement, Dec. 31, 1942 .....	38
Exhibit 5-E—Walts Inc. Balance Sheet, Dec. 31, 1942 .....	40
Exhibit 6-F—Notes Payable .....	41
Exhibit 7-G—Sales .....	42
Exhibit 8-H—Earned Surplus .....	43
Exhibit 9-I—W. J. Cunningham Drawing Ac- count .....	44-45



iv.

	PAGE
Stipulation and Order Extending Time to File, Dec. 15, 1947 .....	79
Transcript of Proceedings .....	90
Witnesses for Petitioner:	
Cunningham, Catherine S.	
—direct .....	212
—cross .....	214
Cunningham, Walter James	
—direct .....	100, 209
—cross .....	134, 210
—redirect .....	170
Temple, Hubert A.	
—direct .....	198
—cross .....	204
—redirect .....	207
—recross .....	208
White, Ernest S.	
—direct .....	178
—cross .....	190
—redirect .....	193, 197
—recross .....	196



## APPEARANCES

For Petitioner:

C. EARLE MEMORY, Esq.,  
GEO. H. ZEUTZIUS, Esq.,  
A. P. G. STEFFES, Esq.

For Respondent:

W. J. McFARLAND, Esq.

---

Docket No. 6974

WALTS, INC., a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transferred to Harlan J. 12/5/46.

## DOCKET ENTRIES

1945

Jan. 23—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 23—Copy of Petition served on General Counsel.

Jan. 23—Notice of the appearance of C. Earle Memory as counsel filed.

Mar. 12—Answer filed by General Counsel.

1945

Mar. 12—Request for hearing in Los Angeles, California filed by General Counsel.

Mar. 15—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1946

Apr. 16—Hearing set June 10, 1946 at Los Angeles, Calif.

June 18—Hearing had before Judge Black on merits. Counsel for petitioner filed written motion to substitute attorneys and to file amendment to petition — respondent objects to latter motion. Motion granted. Copies served. Answer to amendment filed—copies served. Stipulation of facts filed. Petitioner's brief due August 5, 1946—respondent's September 5, 1946—petitioner's reply October 5, 1946.

July 8—Transcript of hearing of 6/18/46 filed.

Aug. 5—Brief filed by taxpayer with proof of service.

Sept. 5—Brief filed by General Counsel.

Oct. 3—Motion for extension to Oct. 30, 1946 to file reply brief filed by taxpayer. 10/3/46 granted.

Oct. 30—Order granting extension to Nov. 5, 1946 to file reply brief entered (Telegram).

Nov. 7—Reply brief filed by taxpayer. 11/8/46 copy served.

1947

- Jan. 17—Memorandum findings of fact and opinion rendered, Harlan J. Decision will be entered under Rule 50—copy served.
- Feb. 17—Motion for rehearing De Novo filed by taxpayer—Denied.
- Mar. 10—Respondent's computation for entry of decision filed.
- Mar. 13—Hearing set April 9, 1947 at Washington, D. C. under Rule 50.
- Apr. 9—Hearing had before Judge Harlan on settlement under Rule 50. Decision to be entered in accordance with respondent's computation.
- Apr. 10—Decision entered Harlan J. Div. 11.
- Apr. 18—Motion to correct decision filed by taxpayer. 4/21/47 denied.
- July 7—Petition for review by U. S. Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.
- July 8—Proof of service filed by taxpayer.
- Aug. 18—Copy of order for U. S. Court of Appeals, 9th Circuit extending time to December 15, 1947 to file record filed.
- Dec. 22—Certified copy of order from the 9th Circuit extending the time to February 1, 1948 to file record filed.

notice of deficiency is based upon the following errors:

(a) The commissioner proposes to disallow the directors' fees paid in the amount of \$1,000.00, and

(b) The commissioner proposes to disallow the compensation paid to two officers, W. J. Cunningham, President, and E. D. Morse, Secretary, in the amount of \$18,000.00 each.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

#### Directors' Fees

Petitioner contends that the directors' fees paid to four directors at \$250 each during the year were reasonable and fair, for services rendered, and are therefore deductible under Section 23(a) of the Internal Revenue Code. During the year 1942 there were 13 directors' meetings held, all of which were after regular business hours and many very vital decisions affecting the welfare of the petitioner came out of such meetings. The petitioner had a very difficult year in 1942 as a great many problems were encountered in obtaining materials and manpower in order for it to fulfill its part in the war production program.

#### Compensation of Officers

The petitioner is basing its contention that the compensation paid to the officers in the year 1942 was deductible under Section 23(a) of the Internal Revenue Code upon tests propounded by the Sec-

retary of Treasury before the Joint Committee on Internal Revenue Taxation where he stated in part, "The factors that will be considered in determining the reasonableness of such payments are the duties performed by the recipient, the character and amount of responsibility, the time devoted to the enterprise and the peculiar ability or special talent of the particular officer or employee . . ." These factors are discussed under the following headings:

**Duties Performed by the Recipients.** Mr. Cunningham functioned as the president of the petitioner and handled all of its relationship with its customers and vendors. Mr. Morse was the secretary of the petitioner and handled all financial and internal management and production of the petitioner. As they went through a very chaotic year in 1942 their respective duties overlapped and they oftentimes had to perform functions other than their own.

**Character and Amount of Responsibility.** Mr. Cunningham and Mr. Morse were jointly responsible for all of the activities of the petitioner including its plant construction, war production, manpower problems, obtaining of licensing agreements with the Aluminum Corporation of America, purchasing of materials, engineering, research, solving of problems encountered by the aircraft industry in their war production, etc.

**Time Devoted to the Enterprise.** Both Mr. Cunningham and Mr. Morse devoted full time to the

business of the petitioner and had no outside interests during the year 1942. Each of these officers averaged 80 hours per week during the year 1942 on the petitioner's business.

Peculiar Ability or Special Talent of the Particular Officer. Mr. Cunningham is 46 years of age and has been a very successful business man for a great many years. He asserts, and the petitioner believes, that he has had an annual income in varying amounts in excess of \$25,000.00 for 14 of the years preceeding his formation of the petitioner. Mr. Morse is 48 years of age and has been a very successful business man for a great many years. The petitioner believes that he has had an annual income in varying amounts in excess of \$25,000.00 for many of the years preceeding his connection with the petitioner, but as Mr. Morse is no longer connected with the petitioner, no more definite information is available to petitioner. Mr. Cunningham organized the petitioner on April 24, 1940 and Mr. Morse joined the petitioner in February, 1941, and during 1940 and 1941 no salaries were drawn as the business was just getting started. The total sales for the year 1941 approximated \$40,000 and resulted in adjusted net income of \$2,339.50. The total sales for the year 1942 approximated \$434,000, resulting in net income of approximately \$30,000 (after deducting \$56,000 officers' salaries) upon which the petitioner paid federal taxes of approximately \$23,000. After allowing for the salaries paid, the petitioner earned 350% on its invested capital and paid federal taxes of 77%

thereof for the year 1942. Total sales for the year 1943 approximated \$964,000 resulting in net income of approximately \$152,000 (after deducting \$78,000 officers' salaries) upon which petitioner paid federal taxes of approximately \$77,000 and refunded to the government on renegotiation approximately \$56,000. The petitioner thus earned 1,388% on its invested capital for 1943 and paid to the government 88% thereof. It is quite obvious to the petitioner that these earnings were possible only because of the personal efforts expended by the two officers in question in building up the petitioner's facilities to handle an increase in volume from \$40,000 in 1941 to 10 times that in 1942 and 24 times that in 1943 without government financing. In three years these officers have built the petitioner's business up to what it is today, believed by the petitioner to be the fourth largest aluminum foundry on the Pacific Coast.

The petitioner contends that the compensation paid to its officers does not reduce the net earnings subject to tax below that of competing concerns that secured the services of officers and employees by open bargaining. The petitioner further contends that the substantial earnings of 350% on invested capital during 1942, while in part due to the urgent need for the petitioner's products in the war production program, was made possible only by the concerted efforts, skills, talents and peculiar abilities of Mr. Cunningham and Mr. Morse.

Wherefore, the petitioner prays that this Court may hear the proceeding and find that no additional excess profits taxes and/or declared value excess profits taxes are due from the petitioner for the taxable year ended December 31, 1942.

/s/ W. J. CUNNINGHAM,  
President for the Petitioner, Walts, Inc., Petitioner, 5511 Boyle Avenue, Los Angeles 11, Calif.,  
Counsel, C. Earle Memory.

State of California,  
County of Los Angeles—ss.

W. J. Cunningham, being duly sworn, says that he is the president of Walts, Inc., a corporation, the above-named petitioner; that he is duly authorized to verify the foregoing petition; that he has read same and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief and that those he believes to be true.

/s/ W. J. CUNNINGHAM.

Subscribed and sworn to before me this 18th day of January, 1945.

(Seal) /s/ ELINOR C. MEMORY,  
Notary Public in and for the County of Los Angeles, State of California.



EXHIBIT "A"

Treasury Department  
Internal Revenue Service  
417 South Hill Street  
Los Angeles 13, California

Office of Internal Revenue Agent in Charge, Los Angeles Division, LA:IT:90D:PAK.

Oct. 27, 1944

Walts, Inc.  
5511 Boyle Avenue  
Los Angeles 11, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1941 and December 31, 1942 discloses an overassessment of \$518.62, that the determination of your declared value excess profits tax liability for the taxable year ended December 31, 1942 discloses a deficiency of \$1,021.20, and that the determination of your excess profits tax liability for the taxable year ended December 31, 1942 discloses a deficiency of \$28,690.00, as shown in the statement attached.

In accordance with the provisions of existing Internal Revenue Laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washing-

ton, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,  
Commissioner.

By GEORGE D. MARTIN,  
Internal Revenue Agent in Charge.

Enclosures: Statement, Form of Waiver, Form 843.

## Exhibit A—(Continued)

## Statement

## Tax Liability for the Taxable Years Ended

December 31, 1941 and 1942

## Income Tax

Year	Liability	Assessed	Overassessment
1941	\$ 253.25	\$ 641.32	\$388.07
1942	1,373.93	1,504.48	130.55
	<hr/>	<hr/>	<hr/>
	\$1,627.18	\$2,145.80	\$518.62

## Declared Value Excess-Profits Tax

Year	Liability	Assessed	Deficiency
1942	\$1,021.20	\$ None	\$1,021.20

## Excess Profits Tax

Year	Liability	Assessed	Deficiency
1942	\$50,187.27	\$21,497.27	\$28,690.00

In making this determination of your tax liability, careful consideration has been given to the report of examination dated June 24, 1944, to your protest dated August 16, 1944, and to the statements made at the conference held on August 30, 1944.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the Collector of Internal Revenue for your district, and will be applied by that official in accordance with Section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent

## Exhibit A—(Continued)

overassessments by filing with the Collector of Internal Revenue for your district claims for refund on Form 843, copies of which are enclosed, the bases of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Mr. Claude I. Parker, 808 Bank of America Building, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income  
Taxable Year Ended December 31, 1941

Net income as disclosed by return.....		\$3,053.93
Unallowable deductions:		
(a) Other deductions decreased .....	\$ 22.40	
(b) Franchise taxes decreased .....	127.25	149.65
Total .....		\$3,203.58
Additional deductions:		
(c) Additional depreciation allowed.....	\$ 249.08	
(d) Capital stock tax allowed.....	625.00	
(e) Net operating loss carryover from 1940	1,123.58	1,997.66
Net income adjusted .....		\$1,205.92

Explanation of Adjustments

(a) The deduction claimed under Other Deductions for office supplies is overstated \$22.40.

(b) The deduction claimed for franchise taxes in the amount of \$152.25 is decreased to \$25.00, the amount allowable under Section 23(c) of the Internal Revenue Code.

Exhibit A—(Continued)

(c) An additional deduction for depreciation is allowed in the amount of \$249.08.

(d) A deduction for capital stock taxes is allowed in the amount of \$625.00.

(e) A deduction is allowed for a net operating loss carryover from 1940 in the amount of \$1,123.58.

Computation of Income Tax

Taxable Year Ended December 31, 1941

Net income adjusted .....	\$1,205.92
Income Tax:	
Normal Tax: 15% of \$1,205.92.....	\$180.89
Surtax: 6% of \$1,205.92 .....	72.36
	-----
Correct Income Tax Liability.....	\$ 253.25
Income Tax Assessed: Original Account No. 411762.....	641.32
	-----
Overassessment of Income Tax.....	\$ 388.07

Adjustments to Net Income

Taxable Year Ended December 31, 1942

Net income as disclosed by return.....	\$29,828.39
Unallowable Deductions:	
(a) Excessive depreciation disallowed.....	\$ 898.22
(b) Compensation of officers disallowed....	36,000.00
(c) Directors' fees disallowed .....	1,000.00    37,898.22
	-----
Total .....	\$67,726.61
Additional deductions:	
(d) Additional capital stock taxes allowed .....	\$ 2,187.50
(e) Additional franchise taxes allowed.....	66.41    2,253.91
	-----
Net income adjusted .....	\$65,472.70

## Exhibit A—(Continued)

## Explanation of Adjustments

(a) The deduction for depreciation claimed in your return is \$898.22 in excess of the amount allowable under Section 23(a) of the Internal Revenue Code.

(b) It is determined, under the provisions of Section 23(a)(1) of the Internal Revenue Code, that the deductions claimed for compensation of certain of your officers are in excess of a reasonable compensation for services rendered by said officers as shown in the following:

Name and Title	Amount Claimed	Reasonable Compensation	Excessive Amount
W. J. Cunningham, Pres.	\$28,000.00	\$10,000.00	\$18,000.00
E. D. Morse, Secty.	28,000.00	10,000.00	18,000.00
Total .....	<u>\$56,000.00</u>	<u>\$20,000.00</u>	<u>\$36,000.00</u>

The excessive amount of \$36,000.00 is disallowed as a deduction.

(c) The deduction claimed for directors' fees in the amount of \$1,000.00 (included in the deduction claimed for salaries and wages) is disallowed.

(d) An additional deduction for capital stock taxes is allowed in the amount of \$2,187.50.

(e) An additional deduction is allowed for franchise taxes in the amount of \$66.41.

## Exhibit A—(Continued)

Computation of Declared Value Excess-Profits Tax  
Taxable Year Ended December 31, 1942

Net income adjusted .....	\$65,472.70
Less: 10% of \$500,000.00 value of capital stock as de- clared in the capital stock tax return for the year ended June 30, 1942 .....	50,000.00
	<hr/>
Net income subject to declared value excess-profits tax....	\$15,472.70
Declared value excess-profits tax:	
6.6% of \$15,472.70 .....	\$1,021.20
Correct declared value excess-profits tax liability.....	\$ 1,021.20
	<hr/>
Declared value excess-profits tax assessed:	
Original, Account No. 1437761.....	None
	<hr/>
Deficiency of declared value excess-profits tax.....	\$ 1,021.20

Computation of Excess Profits Net Income  
Taxable Year Ended December 31, 1942

Excess profits net income as disclosed by return.....	\$20,054.72
Additions:	
(a) Excessive depreciation disallowed ....	\$ 898.22
(b) Compensation of officers and directors disallowed .....	37,000.00
	<hr/>
Total .....	\$67,952.94
Reductions:	
(c) Additional capital stock taxes allowed..	\$2,187.50
(d) Additional franchise tax allowed.....	66.41
(e) Additional declared value excess-profits tax allowed .....	1,021.20
	<hr/>
Excess profits net income adjusted.....	\$64,677.83

## Exhibit A—(Continued)

## Explanation of Adjustments

(a), (b), (c) and (d). These adjustments are the same as those made to net income and previously explained.

(e) A deduction is allowed for declared value excess-profits tax in the amount of the deficiency thereof as shown above in the computation of declared value excess-profits tax.

## Adjustments to Invested Capital

## Taxable Year Ended December 31, 1942

Invested capital as disclosed by return.....		\$7,406.96
Additions:		
(a) Accumulated earnings at January 1, 1942, understated .....		\$891.81
(b) Average borrowed invested capital understated .....	267.80	1,159.61
		<hr/>
Invested capital adjusted .....		\$8,566.57

## Explanation of Adjustments

(a) Amount of accumulated earnings determined.....	\$	930.27
Amount reported (line 4, Schedule C of return).....		38.46
		<hr/>
Additional amount allowed .....	\$	891.81
(b) Average borrowed capital determined.....	\$11,272.60	
Average borrowed capital reported.....	10,736.99	
		<hr/>
Increase .....	\$	535.61
50% of increase .....	\$	267.80

## Computation of Excess Profits Credit

## Taxable Year Ended December 31, 1942

Invested capital .....	\$8,566.57
8% of invested capital.....	\$ 685.33
Excess profits credit .....	\$ 685.33



Exhibit A—(Continued)

Computation of Adjusted Excess Profits Net Income  
Taxable Year Ended December 31, 1942

Excess Profits Net Income.....		\$64,677.83
Less: Exemption .....	\$5,000.00	
Excess profits credit .....	685.33	5,685.33
		<hr/>
Adjusted excess profits net income.....		\$58,992.50

Computation of Excess Profits Tax  
Taxable Year Ended December 31, 1942

Tax under Section 710(a) (1) (A) I.R.C.		
1. Adjusted excess profits net income.....		\$58,992.50
2. Excess profits tax (90% of \$58,992.50).....		\$53,093.25
Tax under Section 710(a) (1) (B) I.R.C.		
3. Net income .....		\$65,472.70
4. Less: Declared value excess-profits tax.....		1,021.20
		<hr/>
5. Surtax net income computed without the credit for in- come subject to excess profits tax.....		\$64,451.50
6. 80% of Item 5 .....		\$51,561.20
7. Income tax as computed below.....		1,373.93
		<hr/>
8. Excess of Item 6 over Item 7.....		\$50,187.27
Tax under Section 710(a), I.R.C.		
9. Excess profits tax, lesser of Items 2 and 8.....		\$50,187.27
10. Correct excess profits tax liability.....		\$50,187.27
11. Excess profits tax assessed:		
Original, Account No. 1437839 .....		\$21,497.27
		<hr/>
12. Deficiency of excess profits tax.....		\$28,690.00

Computation of Income Tax  
Taxable Year Ended December 31, 1942

Net income .....		\$65,472.70
Less: Declared value excess-profits tax.....	\$1,021.20	
Income subject to excess profits tax....	58,992.50	60,013.70
		<hr/>

## Exhibit A—(Continued)

Normal tax net income.....	\$ 5,459.00
Surtax net income .....	\$ 5,459.00
Income Tax:	
Normal Tax:	
15% of \$5,000.00 .....	\$ 750.00
17% of \$ 459.00 .....	\$ 78.03
	-----
Total .....	\$ 828.03
Surtax:	
10% of \$5,459.00 .....	545.90
	-----
Total income tax .....	\$ 1,373.93
Correct income tax liability.....	\$ 1,373.93
Income Tax Assessed:	
Original, Account No. 1437761.....	\$ 1,504.48
	-----
Overassessment of income tax.....	\$ 130.55

[Endorsed]: T.C.U.S. Filed Jan. 23, 1945.

[Title of Tax Court and Cause.]

## ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are declared value excess profits tax and excess profits tax for the year 1942.

4(a)(b). Denies the allegations contained in subparagraphs (a) and (b) of paragraph 4 of the petition.

5. Denies the allegations of facts, contentions and arguments in paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

E. C. CROUTER,

B. M. COON,  
Special Attorneys,  
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Mar. 12, 1945.

---

[Title of Tax Court and Cause.]

#### AMENDMENT TO PETITION

Walts, Inc., by George H. Zeutzius and A. P. G. Steffes, its counsel, with leave of Court first had and obtained, amends its petition filed herein as follows:

Add the following subparagraph to paragraph numbered 4:

(c) The Commissioner of Internal Revenue exceeded his jurisdiction, powers and authority in assuming visitatorial power over the salary pay-

ments through the medium of a disallowance of part of the payments actually made by petitioner to Messrs. Cunningham and Morse during 1942 in the aggregate sum of \$56,000.00.

Insert the following subparagraph immediately after the first sentence of paragraph numbered 5:

(a) Section 23(a)(1)(A) of the Internal Revenue Code allows the deduction of all ordinary and necessary business expenses. Directors' fees aggregating \$1,000.00 were actually paid by petitioner to four of its directors for their attendance and services at directors' meetings during 1942. All such fees were paid pursuant to proper corporate authority and resolutions therefor, were in their entirety ordinary and necessary business expenses of petitioner for 1942, and were proper and lawful deductions. If this contention be denied, petitioner contends that the fees and salaries involved were allowable for the following reasons:

Add the following paragraph at the end of paragraph numbered 5:

(c) Section 23(a)(1)(A) of the Internal Revenue Code allows the deduction of all ordinary and necessary business expenses. Salaries of \$28,000.00 each were actually paid by petitioner to W. J. Cunningham and E. D. Morse during 1942 as compensation for services rendered by them and said amounts were in their entirety ordinary and necessary expenses incurred and paid by petitioner in the conduct of its business operations.

Substitute the following paragraph for the prayer contained in the petition as heretofore filed:

Wherefore, petitioner prays that this Court may

hear the proceeding, find that no additional excess profits taxes or declared value excess profits taxes are due from petitioner for the taxable calendar year 1942; that the Commissioner acted without authority in undertaking to disallow the directors' fees of \$1,000.00 and \$36,000.00 of the salaries paid; and for such other further and general relief as to the Court may seem meet and proper.

/s/ GEORGE H. ZEUTZIUS,

/s/ A. P. G. STEFFES,  
Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Filed June 18, 1946.

---

[Title of Tax Court and Cause.]

#### ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amendment to petition of the above-named taxpayer, admits and denies as follows:

4(c) Denies the allegations contained in subparagraph (c) of paragraph 4 of the amendment to petition.

5(a) Denies the allegations contained in subparagraph (a) of paragraph 5 of the amendment to petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the amendment to petition.

6. Denies each and every allegation contained in the amendment to petition.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,  
Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

EARL C. CROUTER,

W. J. McFARLAND,  
Special Attorneys,  
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed June 18, 1946.

---

[Title of Tax Court and Cause.]

### STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts should be taken as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith; and each party reserves the right to object to any part of the stipulated facts on any and all grounds he or it may deem proper:

1. Petitioner, *Walts, Inc.*, known also by the fictitious trade name of *Aero Alloys*, was incorporated under the laws of California on April 24, 1940, with an authorized capital stock of \$25,000.00,

divided into 2,500 shares of a par value of \$10.00 per share. Its principal office and place of business is 5511 Boyle Avenue, Los Angeles 11, California.

2. Petitioner's Articles of Incorporation were executed April 22, 1940, by Walter E. Withers, Walter J. Cunningham and J. Robert Muratta, all of Los Angeles, California. By its Articles, which named the three incorporators as its first directors, petitioner was and is authorized, among other things, as follows:

To own, operate, maintain, manage, equip, improve, repair, alter and otherwise deal with, use and enjoy, to invent, design, develop, assemble, build, construct, fabricate, manufacture, buy, import, lease as lessee and otherwise acquire, to mortgage, deed in trust, pledge and otherwise encumber, and to sell, export, lease as lessor, and otherwise dispose of goods, wares, merchandise and personal property of every sort, nature and description.

3. Petitioner's organization meeting was held by its directors, Messrs. Withers, Cunningham and Muratta, on April 25, 1940. Withers was elected president, Muratta was elected vice-president, and Cunningham secretary and treasurer. At this meeting the directors adopted the following resolutions, among others:

Resolved: That whereas, it is deemed to the best interests of this corporation that Fifty (50) Shares of its Common Stock of the par value of Ten (\$10.00) Dollars per share be issued to Walter E. Withers for an assignment and transfer to the corporation of all his right, title and interest in and to the Foundry Equipment, an inventory of

which is attached hereto; and the assets so transferred is of the fair value of \$600.00;

And, whereas, it is deemed to be to the best interests of this corporation that One Hundred (100) Shares of its Common Stock, of the par value of Ten (\$10.00) Dollars per share, be issued and sold:

Fifty (50) Shares to Walter E. Withers.

Fifty (50) Shares to Katharyn S. Cunningham.

Resolved: That the officers of this corporation shall not be entitled to any compensation for any services that might be rendered and that the said corporation shall not employ any person or persons, or incur any liability whatsoever for salaries.

By resolution the president was authorized to enter into an agreement with John and Alex Ruzzamenti for the purpose of putting to use the foundry equipment to be assigned to the corporation by Walter E. Withers and of obtaining production of ornamental fixtures of all kinds and description for sale and distribution.

4. On May 9, 1940, the California Commissioner of Corporations authorized petitioner to issue and sell not to exceed fifty (50) of its shares as consideration for the personal property of Withers (consisting of foundry equipment and supplies) which was first to be transferred and assigned to petitioner free and clear of liens and encumbrances; also to sell and issue to Walter E. Withers and Katharyn S. Cunningham (wife of Walter J. Cunningham), or either of them, an aggregate not to exceed One Hundred (100) of petitioner's shares at par for cash.



5. Walter E. Withers executed a bill of sale to petitioner of his foundry equipment and supplies and a double-end grinder then located at 1170 East Slausson Avenue, Los Angeles, in consideration for the issuance to him of Fifty (50) shares of petitioner's stock. On May 15, 1940, petitioner issued fifty (50) shares of its stock to Withers for said foundry personal property. On the same day an additional fifty (50) shares were issued to Withers for Five Hundred (\$500.00) Dollars in cash. Fifty (50) shares were also issued on May 15th to Katharyn S. Cunningham for cash. At all times between May 15, 1940, and December 31, 1942, inclusive, petitioner's issued and outstanding capital stock consisted of \$1,500.00. During 1940 petitioner's outstanding shares were owned, One Hundred by Withers and Fifty by Katharyn S. Cunningham, wife of Walter J. Cunningham. On March 31, 1941, Withers surrendered his certificates for one hundred shares of stock and there was issued in lieu thereof seventy-five (75) shares on March 31, 1941, to E. D. Morse, and twenty-five (25) shares to Katharyn S. Cunningham. From March 31, 1941, through December 31, 1942, petitioner's outstanding stock was owned, seventy-five (75) shares by E. D. Morse and seventy-five (75) shares by Katharyn S. Cunningham.

6. By two separate written agreements dated February 26, 1941, between the Aluminum Company of America, a Pennsylvania corporation, and petitioner, the former as owner of four patented processes for the thermal treatment of casting of alloy compositions, licensed petitioner to use the

same in the factories and shops of petitioner in the United States in consideration for payment of a royalty of one-half cent per pound on all articles produced by petitioner with the use of such processes. By letter dated August 28, 1942, the Aluminum Company of America granted petitioner the right to the use of said processes royalty free from July 1, 1942, until the cessation of hostilities "because of the direct relationship of the heat treatment of aluminum alloy castings to wartime production". Attached hereto and marked Exhibit "1-A" hereof are photostat copies of the above mentioned written agreements dated February 26, 1941, together with a letter dated August 28, 1942, addressed to the petitioner from the Aluminum Company of America.

7. Under date of March 31, 1941, the petitioner's directors authorized and directed petitioner to lease or build and construct an adequate plant and purchase and install equipment to maintain said plant and to do all things necessary to diligently and efficiently establish a plant for the manufacture of aluminum alloys products. For the purpose of obtaining needed funds with which to set up and operate a foundry for the manufacture of sand cast aluminum parts, the then foundry being unsuitable, the directors at their meeting of March 31, 1941, adopted a resolution authorizing the borrowing of \$8,500.00 for the benefit of petitioner from D. M. Morse and to give petitioner's obligation in evidence thereof, said sum to be repaid as soon as sufficient reserves were available. On March 28, 1941, Muratta resigned as a director and vice-pres-

ident and E. D. Morse was appointed a director in his place.

8. By resolution adopted March 28, 1941, petitioner's directors authorized the hiring of employees and the payment of salaries for their services. Pursuant thereto one George E. Schultz was appointed general manager, but never performed any services in that capacity. The board authorized, on March 31, 1941, the payment of salaries of \$200.00 per month to Walter J. Cunningham and \$200.00 per month to E. D. Morse for their services until such time as the directors should determine otherwise. Withers also resigned as a director and president of the corporation on March 31, 1941, and Walter J. Cunningham was appointed president, E. D. Morse secretary-treasurer and director, and George E. Schultz vice-president and director.

9. On July 14, 1941, petitioner's directors authorized the borrowing of Two Thousand (\$2,000.00) Dollars from the Bank of America at Long Beach, to be used for paying outstanding bills and to be repaid to the bank out of monies due petitioner on accounts receivable from the Douglas Aircraft Corporation of Santa Monica, which accounts were payable to petitioner on August 10, 1941. Said resolution was adopted to secure the endorsement of E. D. Morse on the note to the bank for said loan.

10. On October 31, 1941, petitioner's directors adopted a resolution to amend its Articles of Incorporation to provide for four directors instead of three. The necessary steps to amend the Articles were promptly taken.

11. At the annual stockholders' meeting of petitioner on January 5, 1942, the following directors were elected: Walter J. Cunningham, Mrs. Kathryn S. Cunningham, Mrs. Dorothy M. Morse, Elmer D. Morse.

The directors, immediately following the stockholders' meeting, elected said persons president, vice-president, vice-president and secretary-treasurer respectively. At their meeting of January 5, 1942, the foregoing directors adopted resolutions reading as follows:

Resolved: that, notwithstanding any action heretofore taken by the Board of Directors, by resolution or otherwise, that the President, Walter J. Cunningham, be paid at the rate of Twenty-four Thousand Dollars (\$24,000.00) per year for his services, and that the Secretary and Treasurer, E. D. Morse, be paid at the rate of Twenty-four Thousand Dollars (\$24,000.00) per year for his services; and

Be It Further Resolved: that the respective salaries of said Walter J. Cunningham and E. D. Morse, be, and the same hereby are, effective as of and from January 1, 1942, and that same be paid in such installments, monthly or otherwise, as the officers may from time to time elect.

Be It Further Resolved: that it is the intent hereby to revoke any action heretofore taken by the Board of Directors in regard to the respective salaries of said officers.

12. At a meeting held April 10, 1942, petitioner's directors authorized the purchase and installation of a new heat treating furnace at the

cost of approximately \$5,000.00 and the erection of an addition to petitioner's plant, together with necessary equipment, to cost approximately \$3,000.

13. On June 12, 1942, petitioner's directors authorized its president and treasurer to erect an additional building on the north side of petitioner's plant and to purchase necessary equipment at an expenditure of approximately \$2,500.00.

14. At a meeting held August 14, 1942, petitioner's directors adopted a motion "that each director be paid the sum of \$25.00 for attendance at each meeting of the board of directors".

15. At a meeting held August 28, 1942, petitioner's directors adopted resolutions increasing salaries of its president Walter J. Cunningham and its secretary-treasurer E. D. Morse to \$36,000.00 each per year for his services, said salaries to be effective as of September 1, 1942. The minutes stated in part as follows:

The president stated that the increased business of the corporation, and its many new developments, has increased the burdens and the responsibilities and time necessary for the officers to devote to the business of the corporation; therefore,

On motion duly made, seconded and unanimously carried, the following resolution was adopted:

Resolved: that notwithstanding any action heretofore taken by the Board of Directors, by resolution or otherwise, that the President, Walter J. Cunningham, be paid at the rate of Thirty-six

Thousand Dollars (\$36,000.00) per year for his services, and that the Secretary and Treasurer, E. D. Morse, be paid at the rate of Thirty-six Thousand Dollars (\$36,000.00) per year for his services; and

Be It Further Resolved: that the respective salaries of said Walter J. Cunningham and E. D. Morse, be and same hereby are, effective as of and from September 1, 1942, and that same be paid in such installments, monthly or otherwise, as the officers may from time to time elect.

16. At a meeting held September 15, 1942, the minutes recorded were in part as follows:

The President stated that the increased demands upon the business of the corporation made it necessary to consider erection of building and acquiring equipment.

On motion duly made, seconded and unanimously carried the President and Secretary of the corporation were authorized and directed to effect the construction of a new building on premises leased from the American Mineral Company and to obtain necessary equipment for said building, all at a cost of approximately \$9,000.00.

17. During the period August 28, 1942, to December 30, 1942, inclusive, ten recorded directors' meetings were held at which all four directors were present. The discussions in the meetings dealt chiefly with reports on the increase of the business, bank loans, the construction of additions to petitioner's plant, the purchase of necessary additional

equipment, the authorization thereof, and of other expenditures; also that arrangements had been completed for a line of credit with the Bank of America up to Twenty-five Thousand (\$25,000.00) Dollars.

18. During 1942, petitioner's business consisted entirely of the manufacture and sale of airplane parts as a sub-contractor for airplane parts used by aircraft corporations engaged in war work, which said parts were made of aluminum by use of the heating processes covered by the licensing agreements with the Aluminum Company of America.

19. Petitioner's gross sales in 1940 were \$1,227.38, and it sustained an operating loss for the year ending December 31, 1940, in the amount of \$1,123.58. No salaries were paid by petitioner to any of its officers or directors during 1940. During 1941 petitioner's gross sales amounted to \$39,996.19, and respondent determined that petitioner had an adjusted net taxable income of \$1,205.92. During 1941 it paid salaries to its officers aggregating \$3,300.00, of which \$1,650.00 was paid to its president, Walter J. Cunningham, and \$1,650.00 to its secretary, E. D. Morse, both of whom devoted their entire time to petitioner's business and operations. During the calendar year 1942 petitioner's gross sales amounted to \$434,363.44, and its net profit before payment of salaries to its officers amounted to \$85,828.39. During 1942 petitioner paid officers' salaries aggregating \$56,000.00, of which \$28,000.00 was paid to its president, Walter J. Cunningham, and \$28,000.00 to its secretary,

E. D. Morse, both of whom devoted their full time to the business and operations of petitioner. In addition, each of the four directors was paid \$250.00 during 1942 for attendance and services at directors' meetings, being at the rate of \$25.00 per meeting per director for ten of the directors' meetings held during 1942.

No dividends were paid by petitioner at any time during the period April 24, 1941, to December 31, 1942, inclusive.

20. Petitioner kept its books and filed its income and profits tax returns on the accrual and calendar year basis. It filed its income and declared-value excess profits tax returns and excess profits tax returns with the Collector of Internal Revenue for the Sixth Collection District of California at Los Angeles.

21. The Commissioner determined that petitioner had overpaid its 1942 income taxes in the amount of \$130.55, that there was a deficiency of \$1,021.20 in petitioner's 1942 declared-value excess profits tax and a deficiency of \$28,690.00 in petitioner's 1942 excess profits tax. In arriving at said deficiency determination, the Commissioner disallowed \$36,000.00 of the total amount of \$56,000.00 paid equally to Messrs. Cunningham and Morse during 1942 and claimed as a compensation deduction by petitioner for the taxable year 1942. The Commissioner also disallowed \$1,000.00 claimed by the petitioner to have been paid as directors' fees during 1942 to the four directors as follows:

\$250.00 to Walter J. Cunningham;



\$250.00 to E. D. Morse;

\$250.00 to Katharyn S. Cunningham, and

\$250.00 to Dorothy M. Morse.

22. True copies of petitioner's balance sheets and profit and loss statements for the years 1941 and 1942, marked Exhibits "2-B", "3-C", "4-D" and "5-E", are attached hereto and by reference made a part hereof.

23. True copies, per books, of petitioner's notes payable, sales and earned surplus accounts, and of the W. J. Cunningham drawing account are attached hereto, marked Exhibits "6-F", "7-G", "8-H" and "9-I", and by reference made a part hereof. The drawing account for E. D. Morse for the period shown in Exhibit "9-I" is identical in all respects with said Exhibit "9-I". As of December 31, 1942, petitioner's books reflect the entry of a credit of \$500.00 in an account entitled "Paid In Surplus".

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES (by G.H.Z.)  
Counsel for Petitioner.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

\* \* \* \*

## EXHIBIT 2-B

WALTS INC. d/b/a AERO ALLOYS INC.

BALANCE SHEET—DECEMBER 31, 1941

## Assets:

Cash .....	\$ 1,450.98
Notes and Accounts Receivable.....	6,749.13
Inventories:	
Raw Material .....	\$ 750.00
Finished Goods .....	2,500.00
Supplies .....	550.00
	<hr/>
	3,800.00
Depreciable Assets .....	\$9,638.13
Less: Reserve for Depreciation and Amortization .....	796.45
	<hr/>
	8,841.68
Other Assets:	
Deposits .....	\$ 253.90
Organization Expense .....	159.00
	<hr/>
	412.90
	<hr/>
Total Assets .....	\$21,254.69
	<hr/>

## Liabilities:

Accounts Payable .....	\$ 4,987.45
Notes Payable .....	12,000.00
Accrued Payroll .....	534.00

## Other Liabilities:

Accrued Social Security Taxes.....	\$1,372.06
Federal Income and Excess Profits Tax.....	10.22
Federal Capital Stock Tax (1941) .....	312.50
	<hr/>
	\$ 1,694.78
Capital Stock—(Common) .....	1,500.00
Paid-in Surplus .....	500.00
Earned Surplus .....	38.46
	<hr/>
Total Liabilities and Net Worth.....	\$21,254.69
	<hr/>

## EXHIBIT 3-C

WALTS INC. d/b/a AERO ALLOYS INC.

## PROFIT AND LOSS STATEMENT—DECEMBER 31, 1941

Sales .....		\$39,996.19
Cost of Sales:		
Purchases .....	\$ 9,612.56	
Salaries and Wages .....	22,725.89	
Other Costs .....	2,723.48	
	<hr/>	
	\$35,061.93	
Less: Inventory 12/31/41.....	3,800.00	
	<hr/>	
		31,261.93
		<hr/>
Gross Profit.....		\$ 8,734.26
Expenses:		
Compensation Officers .....	\$ 3,300.00	
Rent .....	480.00	
Interest .....	44.42	
Taxes .....	546.34	
Depreciation .....	596.45	
Bank Charges .....	10.06	
Entertainment .....	48.20	
Royalties .....	30.07	
Towels .....	4.35	
Freight and Express .....	53.89	
Insurance .....	98.40	
Utilities .....	58.92	
Office Supplies .....	257.22	
Telephone .....	129.33	
Auto and Delivery Expense.....	52.39	
Advertising .....	30.00	
Permit .....	16.00	
Legal and Audit .....	354.00	
Formula Writeoff .....	1,140.00	
	<hr/>	
		\$ 7,250.04
		<hr/>
Net Profit.....		\$ 1,484.22
		<hr/>

## EXHIBIT 4-D

WALTS INC. d/b/a AERO ALLOYS INC.

PROFIT AND LOSS STATEMENT—DECEMBER 31, 1942

Sales .....		\$434,363.44
Cost of Sales:		
Raw materials, beginning inventory.....	\$ 750.00	
Purchases .....	76,541.49	
		<hr/>
	\$ 77,291.49	
Closing Inventory .....	7,280.35	
		<hr/>
Cost of Raw Materials.....	\$ 70,011.14	
Direct Labor .....	209,770.67	
Depreciation .....	3,313.19	
Freight and Express .....	383.22	
*Supplies .....	2,383.43	
Group Insurance .....	413.60	
Sacks and Boxes .....	1,117.53	
Small Tools .....	1,902.02	
Gates and Risers .....	79.91	
Core Oil .....	834.58	
Sand .....	1,871.41	
Crucibles .....	10,145.03	
Gas and Power .....	5,287.90	
Shop Supplies .....	1,242.89	
Sand Blast .....	7,294.63	
Laboratory and X-Ray .....	2,461.61	
Repairs .....	4,173.02	
Compensation Insurance .....	5,240.48	
Pay Roll Taxes .....	8,412.02	
Patterns .....	515.90	
Miscellaneous Expense .....	243.99	
		<hr/>
	\$337,098.17	
Beginning Inventory, Finished Goods....	2,500.00	
		<hr/>
	\$339,598.17	
Closing Inventory, Finished Goods.....	10,434.20	
		<hr/>
		\$329,163.97
		<hr/>
Gross Profit.....		\$105,199.47

Exhibit 4-D—(Continued)

Expenses:

Executive Salaries .....	\$ 56,000.00
Office Salaries .....	3,326.30
Rent .....	1,700.00
Entertainment .....	2,792.75
Office Supplies and Stationery.....	1,253.22
Telephone and Telegraph .....	431.30
Taxes and Licenses .....	982.35
Payroll Taxes .....	365.72
Legal and Accounting Service.....	1,893.25
Auto Travel .....	2,574.81
Utilities .....	110.74
Repairs .....	660.73
Royalties .....	438.53
Insurance .....	982.58
Interest .....	464.65
Directors' Fees .....	1,000.00
Freight and Express .....	162.71
Subscriptions and Dues .....	31.00
Advertising .....	31.44
Miscellaneous .....	169.02
	\$ 75,371.08
Net Profit.....	\$ 29,828.39

* Supplies Inventory 1/1/42 .....	\$ 550.00
Supplies Purchased .....	2,333.43
	\$2,883.43
Less: Supplies Inv. 12/31/42.....	500.00
Supplies Used .....	\$2,383.43

## EXHIBIT 5-E

WALTS INC. d/b/a AERO ALLOYS INC.

BALANCE SHEET—DECEMBER 31, 1942

## Assets:

Cash .....	\$ 9,406.51	
Notes and Accounts Receivable.....		39,246.36
Inventories:		
Raw Material .....	\$ 7,280.35	
Finished Goods .....	10,434.20	
Supplies .....	500.00	
		<u>18,214.55</u>
Depreciable Assets .....	\$34,747.98	
Less: Reserve for Depreciation and Amortization .....	4,109.64	
		<u>30,638.34</u>
Other Assets:		
Deposits .....	\$ 123.90	
Organization Expense .....	159.00	
Prepaid Insurance .....	2,151.92	
Post War Excess Profits Tax Credit.....	2,149.73	
Tax Refund Claims (State).....	239.76	
Tax Refund Claims (Federal).....	631.10	
		<u>5,455.41</u>
Total Assets.....		<u>\$102,961.17</u>

## Liabilities:

Accounts Payable .....	\$ 28,812.07	
Notes Payable .....		33,500.00
Other Liabilities:		
Accrued Social Security Taxes.....	\$ 5,484.61	
Federal Income and Excess Profits Tax	23,001.75	
Accrued Compensation Insurance.....	559.75	
Employees' Defense Bonds .....	588.16	
		<u>29,634.27</u>
Capital Stock (Common) .....		1,500.00
Paid-in Surplus .....		500.00
Earned Surplus .....		9,014.83
Total Liabilities and Net Worth.....		<u>\$102,961.17</u>

EXHIBIT 6-F

NAME *Mater Payables*  
 ADDRESS

CREDIT LIST

LINE NO.	DESCRIPTION	DATE	CHARGE	CREDIT	BALANCE
10	D. W. Moss	9		850000	
11	K. S. Cunningham	"		114000	
12	Bank of America	"	114000		750000
13	Bank of America	9		200000	1050000
14	K. D. Morris	9	100000	100000	
15	Bank of America	"		350000	
16	"	"	200000		1200000
17	K. D. Morris	9	100000		1100000
18	Bank of America	9	350000		750000
19	Adj. not in chg. - 3/31	9		100000	850000
20	Bank of America	9		7500000	3350000
21	Bank of America	CD 191	200000		3150000
22	"	CD 209	200000		2950000
23	"	163	200000		2750000
24	"	174	200000		2550000
25	"	115	200000		2350000
26	"	141	200000		2150000
27	Bank of America	204		2500000	
28	Bank of America 13100 - D. W. Moss 8500	207	2150000		2500000
29	Bank of America	770	400000		2100000
30	"	737	400000		1700000
31	"	245	400000		1300000
32	"	273	400000		900000
33	Bank of America	287	400000		500000
34	"	307	500000		0





EXHIBIT 7-G

SHEET NO.  
CREDIT RATING

CREDIT LIMIT

NAME *Sales*  
ADDRESS

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
Aug 31		77	75 08	7783 95	7708 87
Sept 30		83	58 05	3148 24	10357 09
Oct 31		85	138 77	6065 77	
Nov 30		77	147 55	10711 40	26789 91
Dec 31		15	446 54	13707 82	39996 19
"	P. & L.	16	39996 19		0
1942					
Jan 31		77	466 19	14448 57	11984 38
Feb 28		78	861 96	14201 25	25321 67
Mar 31		76	491 78	17675 80	47455 69
Apr 30		45	423 17	23493 06	65515 58
May 31		55	557 51	76056 85	91019 92
Jun 30		65	1561 10	37399 59	146859 37
July 31		73	1786 76	45683 39	170755 49
Aug 31		84	1661 46	46253 19	215347 22
Sept 30		92	2571 33	50935 62	263711 51
Oct 31		107-A	3646 97	51894 13	311758 67
Nov 30		114	2095 89	59821 33	369684 11
Dec 31		175	7710 35	66589 71	434363 44
"	P. & L.		434363 44		0
1943					
Jan 31			7773 11	70697 28	69469 17
Feb 28		151	1986 84	84636 68	151118 93
Mar 31		163	1679 80	97081 40	246500 53
Apr 30		174	7793 84	73572 65	337799 36
May 30			7345 54	63793 78	399247 63
Jun 30			3943 48	78905 60	474109 77
July 31			1466 64	79146 68	551789 76
Aug 31			3940 40	69484 67	617534 83
Sept 30			1649 72	69400 44	685094 75
Oct 30			3174 08	95071 41	776987 09
Nov 30			4577 96	101242 23	873646 35
Dec 31			2867 20	94083 10	964867 25
"	P. & L.		964867 25		0



EXHIBIT 8-H

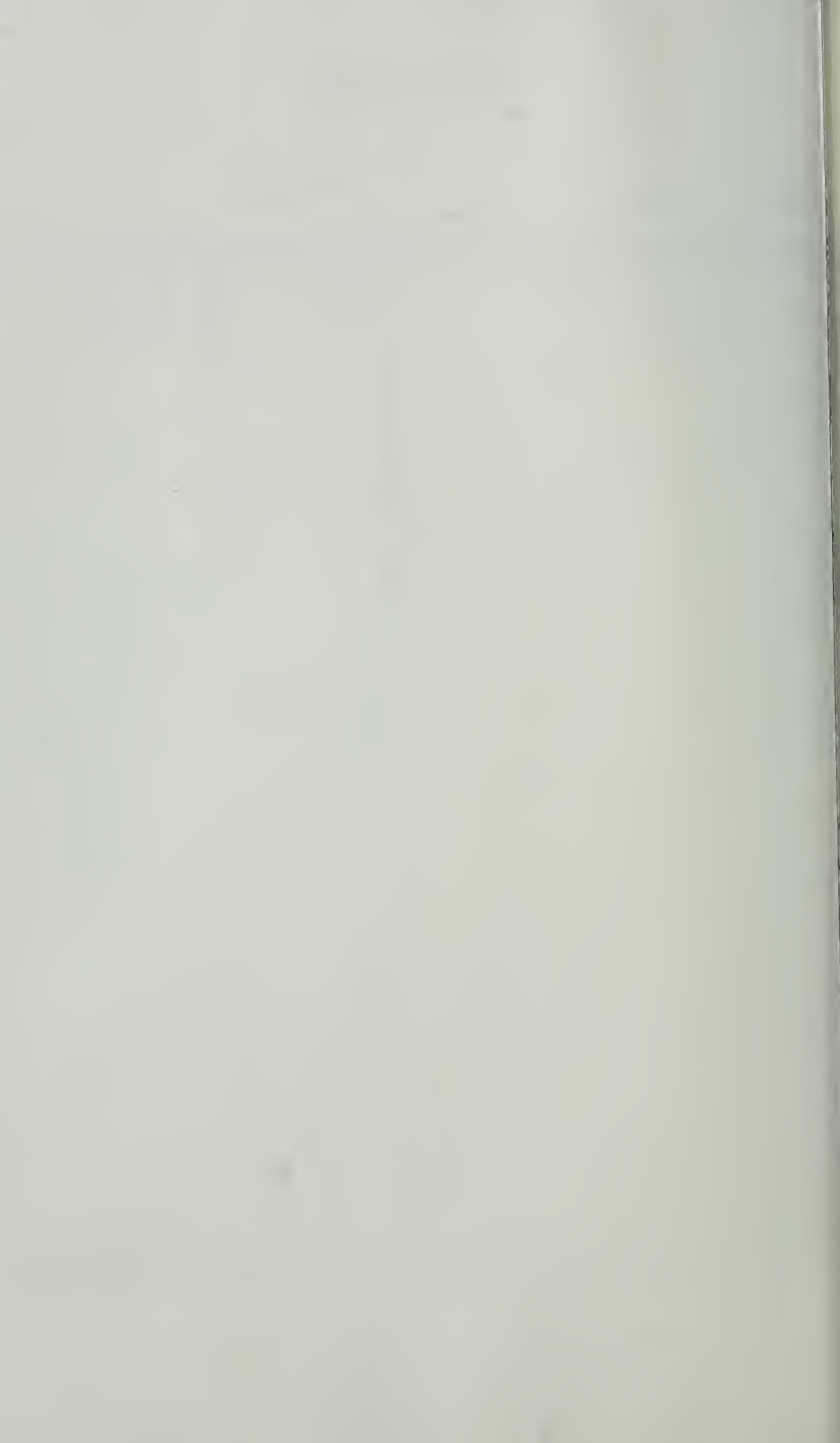
SHEET NO.  
CREDIT RATING

CREDIT LIMIT

NAME *Karred Surplus*  
ADDRESS

BALANCE CARRY OVER

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
Dec 31	P.R.	16		3181 18	
"	Acc. Inv. Inc. Fed	"	668 05		
"	" " " State	"	177 75		2355 8
<u>1942</u>					
Dec 31	P.R.			39719 93	
"	Inc. les trans.			26 98	44137 5
"	Apartment 1940	1264	1477 38		
"	" 1941	"	875 04		
"	" 1942	"	30770 79		9014 8
<u>1943</u>					
Dec 31		2224	177142 18	164877 49	51744 1
<u>1944</u>					
July 19		356		44820 84	
"		"	54046 05		40538 9
Dec 31		419	44820 8	90784 73	176941 5
Feb 28	1000 Inc.	441	65829 17		61017 4
Dec 31	1005 Inc. 1474.61	552		5832 17	66844 5



# EXHIBIT 9-1

SHEET NO.

CREDIT RATING

CREDIT LIMIT

NAME *M. J. Cunningham Law*  
 ADDRESS *Drawing Dept*

DATE	DESCRIPTION	POSTING REFERENCE	CHARGES	CREDITS	BALANCE
June 30		91	50.00		50.00
July 31		"	175.00		175.00
Aug 31		94	175.00		300.00
Sept 30		95	200.00		500.00
Oct 31		95	250.00		750.00
Nov 30		97	200.00		950.00
Dec 31		95	400.00		1350.00
"	Salary 3 Mos @ 200 <sup>00</sup> 3 Mos @ 350 <sup>00</sup>	916	330.00	1650.00	2670.00
Jan 31		ER 13	200.00		670.00
Feb 28		978	300.00		2330.00
Mar 31	Salary 3 Mos @ 1000 <sup>00</sup> En Dec Dec	936		2940.00	
"	"	936	175.00		2607.00
"	"	"		75.00	2557.00
"	"	"	50.00		
Apr 3		ER 31	250.00		
10		ER 32	150.00		
15		ER 34	150.00		
24		ER 36	150.00		
30		ER 40	150.00		
May 4	Salary	955A		1000.00	2707.00
31	Salary	955	600.00		
June 30	Salary check	"		1000.00	3107.00
"	Salary	965	1500.00		1607.00
"	Ad. 6 Mos. per Minutes 1/14	"		1000.00	2607.00
July 31	check -	973A	994.24		
"	Group Ins	973A	516		7607.00
"	Salary	"		2000.00	9607.00
Aug 31	check -	984	994.80		
"	Group Ins	"	516		8607.00
"	Salary	"		2000.00	10607.00
Sept 30	check -	992A	645		
"	Salary	"	1743.55		
"		"		3000.00	14357.00



SHEET NO.  
CREDIT RATING

CREDIT LIMIT

NAME  
ADDRESS

*W. J. Cummings and  
drawing acct*

BALANCE BROUGHT

DATE	DESCRIPTION	FOR THE REFERENCE	CHARGES	CHECK	CREDITS	CHECK	BALANCE
	<i>bal fwd</i>						173570
<i>Oct 31</i>		<i>107A</i>	200000		300000		133570
<i>Nov 30</i>		<i>114</i>	375000		300000		126070
<i>Dec 11</i>	<i>ch</i>	<i>22</i>	75000				
<i>19</i>	"		75000				
<i>24</i>	"		75000				
<i>30</i>	"		75000				
<i>4</i>	"		145000				
<i>"</i>	"		10700				
<i>31</i>	<i>Salary</i>				300000		0





The Tax Court of the United States

[Title of Cause.]

George H. Zeutzius, Esq., and A. P. G. Steffes, Esq., for the petitioner. W. J. McFarland, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND  
OPINION

Harlan, Judge: The respondent determined a deficiency in the declared value excess profits tax of petitioner for the year 1942 in the amount of \$1,021.20, and in excess-profits taxes for the same year in the amount of \$28,690.

The questions involved are:

1. Whether respondent correctly disallowed certain amounts as deductions by petitioner on the ground that they constituted exclusive compensation for services rendered by W. J. Cunningham and E. D. Morse during the year 1942, and
2. Whether the respondent correctly disallowed amounts paid by petitioner to each of its directors during the same year.

FINDINGS OF FACT

Petitioner, Walts, Inc., known also by the fictitious name of Aero Alloys, has its principal office and place of business in Los Angeles, California. Its books are kept and its returns filed on the accrual and calendar year basis. Its return for 1942 was filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles.

sum of \$1,140 in obtaining them. A resolution was adopted directing that she be reimbursed for the moneys expended. The directors also authorized the leasing or construction of an adequate plant and the purchase and installation of equipment to maintain said plant for the manufacture of aluminum alloys products. For the purpose of obtaining needed funds, the directors authorized the borrowing of \$8,500 from Dorothy M. Morse, the wife of Elmer D. Morse. The authorized loan was made and petitioner gave its note for \$8,500 to Dorothy M. Morse. Thereafter a building 40x60 feet was leased.

At the March 31, 1941, meeting the board also authorized the payment of salaries of \$200 per month each to Walter J. Cunningham and Elmer D. Morse for their services. It accepted the resignation of Muratta as a director and vice-president and appointed Morse to succeed him as a director. Withers resigned as a director and president of the corporation, and Walter J. Cunningham was appointed president and Morse secretary and treasurer.

At or about the time of the March, 1941, meeting Katharyn S. Cunningham became the owner of 75 shares of petitioner's outstanding stock and Elmer D. Morse the owner of the remaining 75 shares, and this ownership of stock prevailed throughout the remainder of the year 1941 and during the year 1942.

On January 5, 1942, the stockholders of petitioner had a meeting and elected Walter J. Cunningham, Katharyn S. Cunningham, Dorothy M. Morse, and Elmer D. Morse to be directors. At a

directors' meeting on the same day a resolution was adopted that Walter J. Cunningham and Elmer D. Morse each be paid at the rate of \$24,000 per annum for their services effective as of January 1, 1942. Cunningham was elected president, Mrs. Cunningham vice-president, Morse secretary and treasurer, and Mrs. Morse vice-president.

At a meeting held April 10, 1942, petitioner's directors authorized the purchase and installation of a new heat treating furnace at the cost of approximately \$5,000 and the erection of an addition to petitioner's plant, together with necessary equipment, to cost approximately \$3,000.

On June 12, 1942, petitioner's directors authorized its president and treasurer to erect an additional building on the north side of petitioner's plant and to purchase necessary equipment at an expenditure of approximately \$2,500.

At a meeting held August 14, 1942, petitioner's directors adopted a motion "that each director be paid the sum of \$25 for attendance at each meeting of the board of directors".

On August 28, 1942, the Aluminum Company of America wrote petitioner that because of the direct and immediate relationship of the heat treatment of aluminum alloy castings to war time production, the license agreement of February 26, 1941, was to be royalty-free from July 1, 1942, until the cessation of hostilities.

At a meeting held August 28, 1942, petitioner's directors adopted resolutions that Walter J. Cunningham and Elmer D. Morse each be paid at the

rate of \$36,000 per year for their services effective as of September 1, 1942.

During the period August 28, 1942, to December 30, 1942, inclusive, ten recorded directors' meetings were held at which all four directors were present. The discussions in the meetings dealt chiefly with reports on the increase of the business, bank loans, the construction of additions to petitioner's plant, the purchase of necessary additional equipment, the authorization thereof, and of other expenditures; also that arrangements had been completed for a line of credit with the Bank of America up to Twenty-five Thousand Dollars.

During 1942, petitioner's business consisted entirely of the manufacture and sale of airplane parts as a sub-contractor for airplane parts used by aircraft corporations engaged in war work, which said parts were made of aluminum by use of the heating processes covered by the licensing agreements with the Aluminum Company of America.

Petitioner's gross sales in 1940 were \$1,227.38, and it sustained an operating loss for the year ending December 31, 1940, in the amount of \$1,123.58. No salaries were paid by petitioner to any of its officers or directors during 1940. During 1941 petitioner's gross sales amounted to \$39,996.19, and respondent determined that petitioner had an adjusted net taxable income of \$1,205.92. During 1941 it paid salaries to its officers aggregating \$3,300, of which \$1,650 was paid to its president, Walter J. Cunningham, and \$1,650 to its secretary, E. D. Morse, both of whom devoted their entire time to

petitioner's business and operations. During the calendar year 1942 petitioner's gross sales amounted to \$434,363.44, and its net profit before payment of salaries to its officers amounted to \$85,828.39. During 1942 petitioner paid officers' salaries aggregating \$56,000, of which \$28,000 was paid to its president, Walter J. Cunningham, and \$28,000 to its secretary, E. D. Morse, both of whom devoted their full time to the business and operations of petitioner. In addition, each of the four directors were paid \$250 during 1942 for attendance and services at directors' meetings, being at the rate of \$25 per meeting per director for ten of the directors' meetings held during 1942.

No dividends were paid by petitioner at any time during the period April 24, 1941, to December 31, 1942, inclusive.

The gross sales per books of petitioner reflect the following monthly cumulative balances for the period August 31, 1941, to December 31, 1943, inclusive:

Aug. 31, 1941	\$ 7,208.87	Nov. 30, 1942	\$369,684.11
Sept. 30, 1941	10,357.09	Dec. 31, 1942	434,363.44
Nov. 30, 1941	26,789.91		
Dec. 31, 1941	39,996.19	Jan. 31, 1943	\$ 68,469.17
		Feb. 28, 1943	151,118.93
Jan. 31, 1942	\$ 11,982.38	Mar. 31, 1943	246,500.53
Feb. 28, 1942	25,321.67	April 30, 1943	337,799.36
Mar. 31, 1942	42,455.69	May 30, 1943	399,247.60
April 30, 1942	65,515.58	June 30, 1943	474,109.72
May 31, 1942	91,019.92	July 31, 1943	551,789.76
June 30, 1942	126,858.37	Aug. 31, 1943	617,334.03
July 31, 1942	170,755.49	Sept. 30, 1943	685,084.75
Aug. 31, 1942	215,347.22	Oct. 30, 1943	776,982.08
Sept. 30, 1942	263,711.51	Nov. 30, 1943	873,646.35
Oct. 31, 1942	311,958.67	Dec. 31, 1943	964,862.25

In determining the deficiencies, the Commissioner disallowed \$36,000 of the total amount of \$56,000 paid equally to Cunningham and Morse during 1942 and claimed as a compensation deduction by petitioner for the taxable year 1942. The respondent also disallowed directors' fees totalling \$1,000, paid to the four directors for attendance at ten meetings, at the rate of \$25 per meeting.

During the year 1942, both Cunningham and Morse devoted from twelve to fourteen hours each day to their duties as president and secretary and treasurer. Cunningham performed a variety of duties during that year including those of general and production manager, sales promotion, metallurgist, shipping clerk, and inspector of castings. Morse, who operated several sporting goods stores prior to his association with petitioner, handled the financial end of the business, office detail, and matters pertaining to the scheduling of parts out of the foundry. Morse severed his connections with petitioner in June, 1943.

The profit and loss account appearing on the books of the petitioner for the years 1941 and 1942 reflects the following:

	1941	1942
Sales .....	\$39,996.19	\$434,363.44
Cost of goods sold.....	31,261.93	329,163.97
Gross profit .....	8,734.26	105,199.47
Compensation of officers.....	3,300.00	56,000.00
Other expenses .....	3,950.04	19,371.08
Net profit (before taxes).....	1,484.22	29,828.39

A reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner as president and secretary-treasurer, respectively, during the year 1942 was \$10,000 per annum for each.

A reasonable allowance for directors' fees for services rendered by the four directors of petitioner at ten meetings attended by them during the period of August 28, 1942, to December 31, 1942, inclusive, was \$25 per meeting, or a total of \$1,000.

### OPINION

The first contention of petitioner is that the respondent is without power to partially disallow as excessive previously authorized salaries actually paid by petitioner during the taxable year 1942, for services rendered to it in the carrying out of its business.

We are not impressed by this contention. Section 23(a)(1)(A) provides that in computing net income there shall be allowed as a deduction "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered \* \* \*." The petitioner argues that the "including" clause was added by Section 234(a)(1) of the Revenue Act of 1918 to make provision for a reasonable allowance as compensation for services rendered, though none was actually paid, in order to rectify the hardship worked upon partnerships, individual proprietorships and closely held corporations by the excess profits provisions of the Act of October 3, 1917, and that the amendment was intended as a liberalization rather than a restriction in its application. Even if it be assumed that petitioner is correct in its argument, respondent's inquiry as to reasonableness could not be logically limited to amounts not actually paid. In *Botany Worsted Mills v. United*

States, 278 U. S. 282, a case which arose under the 1916 Act as amended by the War Revenue Act of 1917, prior to the addition of the so-called "including" clause, the Supreme Court of the United States said:

\* \* \* it is clear that extraordinary, unusual and extravagant amounts paid by a corporation to its officers in the guise and form of compensation for their services, but having no substantial relation to the measure of their services and being utterly disproportioned to their value, are not in reality payment for services, and cannot be regarded as "ordinary and necessary expenses" within the meaning of the section; and that such amounts do not become part of the "ordinary and necessary expenses" merely because the payments are made in accordance with an agreement between the corporation and its officers. Even if binding upon the parties, such an agreement does not change the character of the purported compensation or constitute it, as against the Government, an ordinary and necessary expense. Compare 20 Treas. Dec., Int. Rev., 330; *Jacobs & Davies v. Anderson* (C.C.A.) 228 F. 505, 506; *United States v. Philadelphia Knitting Mills Co.* (C.C.A.) 273 F. 657, 658; and *Becker Bros. v. United States* (C.C.A.) 7 F. (2d) 3, 6.

Subsequent to this decision and the incorporation of the "including" clause in section 23(a)(1)(A), this and other tribunals, in a long line of decisions, have decided that where issue is joined on the question of reasonableness of salaries paid for services rendered, the Commissioner's determination carries a clear presumption of correctness and places upon



the taxpayer the burden of proving that it is entitled to a deduction larger than that determined by the Commissioner. The holding of this tribunal in *Gustafson Manufacturing Company*, (1925), 1 B.T.A. 508, involving the application of Section 234(a) of the Revenue Act of 1918, which brought into the statute the "including" phraseology, that "Under the provision of this section the Commissioner not only has the authority but it is his duty to determine \* \* \* the reasonableness or unreasonableness of deductions by a corporate taxpayer of compensation paid" has been consistently followed. Moreover, the exact wording of what is now Section 23(a)(1)(A), I.R.C. has been incorporated in every revenue act since 1918, and the respondent's regulations have been substantially the same in each reenactment. These regulations have uniformly stated that the test of deductibility of compensation payments is whether they are reasonable and are in fact payment for services. The continued reenactment of the statute must be construed as legislative approval of these regulations. Our conclusion is that the Commissioner has the power under Section 23(a)(1)(A), to disallow as deductions any part of compensation paid which, in his judgment, does not meet the test of reasonableness.

The second contention of petitioner is that the amounts of \$28,000 each paid to Cunningham and Morse during 1942, represent reasonable compensation for services rendered and are allowable deductions for that year. We have found as a fact that \$10,000 per annum for each of these officers constituted reasonable compensation. It follows that our

conclusion is that the remainder of the compensation paid was excessive.

In reaching this conclusion we have carefully considered and weighed the stipulated facts, testimony submitted at the hearing, and the documentary evidence. This reveals to our satisfaction that neither Cunningham nor Morse, at the time each of them became officers of petitioner, were qualified either by training or experience to render unique or specialized services. Cunningham had had a long and varied experience in the lumber business and Morse had operated several sporting goods stores. While it appears that both of them devoted long hours to their respective duties, petitioner's success from August, 1941 to and including 1942, was primarily attributable to the acquisition of the license to use the heating processes owned by the Aluminum Company of America in producing aluminum parts for aircraft corporations and to the demand for such parts during the war years.

The evidence also convinces us that the value of services rendered or to be rendered was not the guiding factor which influenced the directors in authorizing large salaries to be paid to their two officers. On December 31, 1941, the books of petitioner disclose a surplus of \$38.46. Five days later, on January 5, 1942, the directors—Cunningham, Morse and their respective wives—adopted a resolution that the salaries of Cunningham and Morse be increased from \$1,650 per annum received by each in 1941, to \$24,000 per annum. When Cunningham was asked what yardstick was used to determine the amount of salaries voted at this meeting, he replied “past ex-

perience and performances'' and stated that what might occur subsequent to January 5, 1942, was not taken into consideration. When his attention was called to the fact that the gross sales of the company for 1941 were only \$30,996.19, he stated that perhaps they took into consideration previous work that had been done in forming the corporation and that no compensation was received for this work. Cunningham's wife testified that the reason the directors authorized this increase was that her husband had been in the habit of earning that amount of money in the past.

On August 28, 1942, the same day the Aluminum Company of America wrote petitioner that it would have the use of the heat treatment of aluminum alloy castings royalty-free from July 1, 1942, until the cessation of hostilities, petitioner's directors voted Cunningham and Morse a further increase in salary at the rate of \$36,000 per annum effective September 1, 1942. Petitioner's sales which amounted to \$11,982.38 at the end of January, 1942, aggregated \$170,755.49 as of July 31, 1942. Cunningham testified that this increase in sales possibly had some bearing on the increase in salaries. His wife testified that increased production and increased responsibilities warranted the increase to \$36,000 for her husband and Morse. Cunningham on redirect examination testified that on January 5, 1942, the business outlook for petitioner was very promising inasmuch as it had actual orders at that time totalling \$35,000 or \$40,000, and that on August 28, 1942, it had a backlog of unfilled orders of approximately \$500,000.

Petitioner paid Cunningham and Morse \$28,000

each, a total of \$56,000, during 1942, and at the end of the year its books disclosed an earned surplus of only \$9,014.83. Prior to December 31, 1942, it had never distributed any dividends to its stockholders. At all times material herein its stock was owned 50 per cent by Cunningham's wife and 50 per cent by Elmer D. Morse. The salaries paid to Cunningham and Morse were in direct relationship to the stockholdings of the respective families. Although an unimpressive attempt was made to prove that the petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham, evidence as to the value of Morse's services is limited to testimony that as secretary-treasurer he worked long hours, handled the office detail, scheduled the parts out of the foundry, and did the financing. The equality of compensation paid to these two officers seems to us to be inconsistent with an intention to compensate them on the basis of the value of the services they rendered and the evidence presented indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends. Petitioner has not proved to our satisfaction that a salary of \$10,000 per annum for each of them, which was allowed as a deduction by the respondent, did not constitute reasonable compensation for their services.

The remaining issue relates to the fees of \$25 per meeting paid to the four directors of petitioner for attendance at ten meetings, or a total of \$1,000 which was disallowed by the respondent as a deduction for 1942. The evidence discloses that the meetings were

held, that they were attended by all of the directors, and that matters such as business progress, bank loans, construction of additions to plant, purchase of necessary additional equipment and its authorization, and other expenditures, were considered. Our best judgment is the \$1,000 paid to the directors in 1942 constituted reasonable compensation and we have made a finding to this effect. Respondent should have allowed this amount as a deduction.

Decision will be entered under Rule 50.

Entered Jan. 17, 1947.

[Endorsed]: T.C.U.S. Filed Jan. 9, 1947.

---

[Title of Tax Court and Cause.]

### MOTION FOR REHEARING DE NOVO

Petitioner *Walts, Inc.*, a corporation, by *Geo. H. Zeutzius* and *A. P. G. Steffes*, its attorneys, moves the Court to grant an entirely new hearing or rehearing de novo of the above proceeding, and for grounds therefor states:

1. On March 15, 1946, this Court placed this proceeding on the Los Angeles, California, circuit calendar for hearing on the merits.

2. On April 16, 1946, this Court set June 10, 1946 at Los Angeles, California, as the time for said hearing.

3. On June 18, 1946, this proceeding was heard on its merits at Room 229, Post Office and Court House Bldg., Los Angeles, California, before Judge

Eugene Black, who was designated and assigned by the Presiding Judge of this Court, pursuant to Sec. 1103, I.R.C., as a one-judge Division to hear and determine this as well as certain other proceedings at Los Angeles.

4. Under Sec. 1118, I.R.C., it became and was the duty of said Judge Black, as such one-judge Division of this Court, not only to hear but also to determine this proceeding and make a written report thereon and, pursuant to Sec. 1117(b), I.R.C., include in said written report his findings of fact or opinion or memorandum opinion. Section 1118(a), I.R.C., states, in part: "A division shall hear, and make a determination \* \* \*."

5. At the hearing on June 18, 1946, petitioner introduced in evidence the testimony of four witnesses, and exhibits were offered by both sides, together with a partial stipulation of facts. Briefs were filed and, as late as October 30, 1946, said Judge Eugene Black entered an order in this case extending the time for filing petitioner's reply brief.

6. Without any notice of any kind to petitioner of any substitution of Judges, or any order entered or docketed in the case, this proceeding was decided and determined by Judge Byron B. Harlan, whose term of office commenced in March, 1946. Judge Harlan was not present at the hearing in Los Angeles and he did not see or hear any of the four witnesses who testified. Nevertheless, Judge Harlan undertook to determine the issues involved, factual and legal, and filed herein, on January 17, 1947, a written memorandum of his findings of fact and opinion, in

which the disallowance by respondent of \$36,000 of salary deductions was sustained. The first knowledge that petitioner or its counsel had of the substitution of Judge Harlan for Judge Black to determine the case was obtained upon the receipt on or about January 20, 1947 from this Court of a copy of Judge Harlan's memorandum findings of fact and opinion entered January 17, 1947.

7. Said substitution of Judge Harlan for Judge Black, without notice thereof to petitioner or an opportunity to object to such action, has materially prejudiced petitioner and its rights in this proceeding and has deprived it of the full benefits conferred by statute not only of the right to a public hearing (Sec. 1116, I.R.C.) but also of the right to a decision or determination of the issues and to findings of fact by the trial judge (Sec. 1118(b), I.R.C.).

8. Petitioner feels it has been materially prejudiced and aggrieved by the trial judge not disposing of and deciding this proceeding. The evidentiary findings made do not support the ultimate finding in respect of the "reasonableness" or "unreasonableness" of the salary deductions claimed by petitioner. Moreover, if the fact statements in petitioner's brief, which were accepted by respondent, pursuant to Rule 35(b) of this Court, because of his failure to disagree therewith, and those with respect to which there was an insufficient basis shown for disagreement by respondent in his brief, had been considered and adopted, the ultimate finding or conclusion of Judge Harlan as to the salary deductions would be without support. Even on the basis of the findings, as made,

petitioner states that the findings do not support the conclusion drawn therefrom adverse to petitioner.

9. In view of the rule of the Dobson case, Supreme Court, petitioner will be deprived of due process of law and of its right to a fair and full hearing and consideration of the merits of its case, if the present report, findings, conclusions and opinion of Judge Harlan are permitted to stand.

10. In the trial of an income tax case in a United States District Court, petitioner would be entitled to demand that the trial judge himself decide the case, or that a new trial be granted. There is no lawful basis or authority for refusal of similar treatment by the Tax Court in the instant proceeding.

11. The Tax Court erred in permitting the determination of this proceeding to be made by a judge of this Court who did not hear or try the case, and such action on its part constituted an abuse of discretion, particularly in view of the fact Judge Black at all times since the trial of this case by him has been functioning and is still functioning and serving as a judge of this Court.

12. While the Administrative Procedure Act was pending before Congress, the Attorney General of the United States issued a statement to the effect that the term "‘courts’ includes the Tax Court". This Court in *Elizabeth G. MacDonald v. Commissioner*, Docket No. 6910, by Judge Hill, denied a motion to vacate and set aside memorandum findings and opinion on the ground that the Tax Court is a



“court”. (1947 P-H Par. 70, 339.) Being a court, it follows that this case cannot lawfully be decided by any judge other than Judge Black without a new hearing, or the assent of petitioner, which was never given. *Morgan v. United States*, 298 U. S. 468, 480-481.

13. The Judge who made the findings of fact and conclusions, and who filed the opinion and determination herein, erroneously found and determined each and every issue of fact and law which were submitted to the trial judge for determination, and in particular the legal question of the power, or absence of power, of respondent, under Section 23(a)(1)(A), I.R.C., to pass upon the reasonableness of the salaries involved, in view of the facts in this case.

Wherefore, petitioner prays that its motion for an entirely new hearing de novo, be granted, and also such other general and further relief as may be necessary in the premises.

WALTS, INC.,  
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Denied Feb. 17, 1947. B. B. Harlan, Judge.

[Endorsed]: T.C.U.S. Filed Feb. 17, 1947.

The Tax Court of the United States  
Washington

Docket No. 6974

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to memorandum findings of fact and opinion entered herein January 17, 1947, directing that decision be entered under Rule 50, the respondent, on March 10, 1947, filed a computation for entry of decision which was served on petitioner and came on for hearing on April 9, 1947. Petitioner not having appeared at the hearing or opposed said computation, it is

Ordered and Decided: That there are deficiencies for the taxable year ended December 31, 1942, in declared value excess-profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80.

/s/ BYRON B. HARLAN,  
Judge.

Entered Apr. 10, 1947.

[Title of Tax Court and Cause.]

### MOTION TO CORRECT DECISION

Petitioner, Walts, Inc., by its attorneys, moves the Court to correct its decision entered herein on April 10, 1947 under Rule 50 in the respects hereinafter set forth, and for reasons therefor states:

1. This Court's decision under Rule 50 provides in part as follows: "there are deficiencies for the taxable year ended December 31, 1942, in declared value excess-profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80."

2. Respondent's proposed recomputation statement, which was filed herein on March 10, 1947, stated in part as follows: "Any deficiency or overpayment relating to excess profits tax set forth herein is subject to adjustment for post-war credits according to the provisions" of the Internal Revenue Code. Respondent further stated in Schedule 5, page 2, of his recomputation statement that there was a deficiency in excess profits tax of \$27,942.80 and that a credit was allowable under Sections 780 and 781 of \$4,944.01 and that there was, therefore, a "Net post-war refund" of \$4,944.01.

3. Petitioner therefor states, without prejudice to its right to contest the correctness of the decision in all other particulars by petition for review in the United States Circuit Court of Appeals, that the decision of this Court, entered April 10, 1947, should be corrected to show that proper adjustment should be made in favor of petitioner with respect to the aforesaid credit and/or post-war refund of \$4,944.01.

4. Petitioner did not file anything in opposition to respondent's proposed recomputation under Rule 50 because petitioner was lead to believe by respondent's statement filed herein that propr adjustment or provision therefor would be made by this Court in its decision with respect to the ten per cent post-war credit. See Section 781(c), I.R.C.

Wherefore, and with the express reservation of the right to challenge the correctness of the decision in all other respects and on any other grounds that may be available to petitioner on appeal, petitioner prays that the decision of April 10, 1947 be corrected in accordance with the foregoing information, which is in agreement with respondent's proposed recomputation.

WALTS, INC.,  
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Denied. April 21, 1947.  
Signed B. B. Harlan, Judge.

[Endorsed]: T.C.U.S. Filed April 18, 1947.

[Title of Tax Court and Cause.]

PETITION FOR REVIEW BY THE UNITED  
STATES CIRCUIT COURT OF APPEALS  
FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States  
Circuit Court of Appeals for the Ninth Circuit:

I.

JURISDICTION

Petitioner, Walts, Inc., respectfully petitions this Honorable Court to review the decision of the Tax Court of the United States, entered on April 10, 1947, finding a deficiency in the declared value excess profits tax and in the excess profits tax due from your petitioner for the calendar year 1942, in the respective amounts of \$955.20 and \$27,942.80.

Petitioner is a corporation organized under the laws of the State of California, having its principal office and place of business at Los Angeles, California.

The returns of income and declared value excess profits tax and excess profits tax, in respect of which the aforementioned tax liabilities arose, were filed by your petitioner with the Collector of Internal Revenue for the Sixth Collection District of California, at Los Angeles, California, which office is within the jurisdiction of the Circuit Court of Appeals for the Ninth Judicial Circuit.

Jurisdiction in this Court to review the aforesaid decision of the Tax Court of the United States is founded on Sections 1141 and 1142 of the Internal Revenue Code (Sections 1001-3, Revenue Act of

1926, as amended by Sections 603, Revenue Act of 1928, 1101, Revenue Act of 1932, and 519, Revenue Act of 1934).

## II.

### NATURE OF CONTROVERSY

Petitioner was incorporated in April, 1940 and, during the taxable year 1942, was engaged in the manufacture and sale of aluminum aircraft parts, made in its foundry by sand casting and special heat treating processes.

On October 27, 1944, respondent sent to petitioner a notice of deficiency, as prescribed by Section 272 (a), I.R.C. The notice showed a deficiency of \$1,021.20 in declared value excess profits tax for the taxable year ending December 31, 1942, and a deficiency of \$28,690.00 in excess profits tax for said year.

These claimed deficiencies grew out of several adjustments made by respondent to petitioner's 1942 tax returns, among them the disallowance of \$36,000 of the total compensation of \$56,000 paid to its two principal officers for services actually rendered during the year, and the disallowance of \$1,000 paid as directors' fees. The officers' salaries in question were fixed by previous corporate action. The only reason assigned by respondent, for the disallowance of \$36,000 of the officers' compensation, was shown in his deficiency notice as follows:

“(b) It is determined, under the provisions of section 23(a)(1) of the Internal Revenue Code, that the deductions claimed for compensation of certain

of your officers are in excess of a reasonable compensation for services rendered by said officers as shown in the following:

"Name and Title	Amount Claimed	Reasonable Compensation	Excessive Amount
W. J. Cunningham, Pres.	\$28,000.00	\$10,000.00	\$18,000.00
E. D. Morse, Secty.	28,000.00	10,000.00	18,000.00
Totals	\$56,000.00	\$20,000.00	\$36,000.00

“The excessive amount of \$36,000.00 is disallowed as a deduction.”

(Note: Respondent made no allegation, determination or suggestion in his deficiency notice that the disallowed amounts constituted a distribution of earnings or dividends in the guise of salaries or compensation.)

On January 23, 1945, petitioner filed a petition with the Tax Court of the United States seeking a redetermination of its 1942 tax liabilities, alleging that respondent erred in making each of the aforesaid adjustments.

On March 12, 1945, respondent filed his answer to the petition, merely denying all errors assigned and the facts alleged in support thereof, and praying that the Tax Court approve his determination of petitioner’s tax liabilities for 1942. No facts or statements were alleged by respondent in support of or in connection with his denials.

On June 18, 1946, petitioner filed an amendment to its petition, adding to the errors previously assigned the further allegation that respondent exceeded his jurisdiction, powers and authority in assuming visitatorial power over the salary payments through the medium of a disallowance of part of the

payments actually made by petitioner during 1942 for services actually rendered in the conduct of petitioner's business operations. Respondent filed his answer to this amendment to petitioner's petition on June 18, 1946, merely denying all allegations, without setting forth any additional facts or statements of any matters upon which respondent intended to rely for defense.

Thereafter, on June 18, 1946, the cause came on for hearing at Los Angeles before Division 15 of the Tax Court, to which Judge Eugene Black was assigned by the Presiding Judge of the Tax Court, in accordance with law, as a one-member Division of the Tax Court of the United States. As such one-member Division, it became and was the statutory duty of said Judge Black to hear and determine petitioner's case. Judge Black, on June 18, 1946, did hear the case, as trial judge, at Los Angeles.

On January 17, 1947, without prior notice to petitioner or its counsel that the trial judge was not going to decide the case, a "Memorandum of Findings of Fact and Opinion" was rendered and filed in the cause by Judge Byron B. Harlan, whose term as a Judge of the Tax Court commenced June 2, 1946. There was no entry of any order of transfer of the case from Judge Black to Judge Harlan, who was the incumbent of Division 11 of said court. The docket in the case also fails to show any official action transferring the case for decision. Neither petitioner nor its counsel had any knowledge or notice whatsoever that its case had been transferred to another judge for decision.

In said memorandum of findings of fact and opin-



ion, the rulings were in favor of respondent and against petitioner on all issues involved, with the exception of the issue on the disallowance of \$1,000 of directors' fees, which fees were allowed.

On April 10, 1947, the Tax Court of the United States, by Judge Byron B. Harlan, entered its decision in the above-entitled cause as follows:

“Ordered and decided: That there are deficiencies for the taxable year ended December 31, 1942, in declared value excess profits tax and excess profits tax in the respective amounts of \$955.20 and \$27,942.80.”

On February 17, 1947, petitioner filed a motion for rehearing *de novo* and for such other general relief as may be necessary in the premises, which motion was accepted for filing and was referred to Judge Byron B. Harlan of the Tax Court of the United States, who, upon consideration thereof, denied the same under date of February 17, 1947. One of the grounds of this motion was that petitioner had the right by statute to have the trial judge both hear and determine the case. Other grounds concerned the sufficiency of the findings as support for the adverse conclusions made, erroneous findings on the issues because of the Tax Court's failure to apply its own rules respecting briefs and other errors which operated to deprive petitioner of its right to a public hearing and a determination by the trial judge of the issues tried.

On April 18, 1947, petitioner filed a motion to correct the decision entered April 10, 1947, set forth above, which motion was denied on April 21, 1947 by Judge Byron B. Harlan, acting for the Tax

Court of the United States. The ground of this motion was that the Tax Court failed, in entering its decision under Rule 50, to allow or make proper adjustment in its deficiency computation for the ten per cent (10%) postwar credit of \$4,944.01 provided for under Sections 780 and 781, I.R.C., and set forth in respondent's computation for entry of decision, filed in the proceeding.

### ASSIGNMENT OF ERRORS

The Tax Court of the United States committed the following errors, which petitioner assigns and relies upon as the basis of this proceeding:

1. The Court erred in not allowing petitioner, in its decision entered pursuant to Rule 50, the ten per cent (10%) post-war credit of \$4,944.01, admittedly allowable under Sections 780 and 781, I.R.C., and in denying petitioner's motion to correct its decision, in respect thereof.

2. The Court erred in permitting and causing the determination of the issues presented by the pleadings herein to be made by an unauthorized one-member Division of the Court, which did not try the case, hear the evidence or observe the witnesses.

3. The Court erred in denying petitioner's motion for rehearing de novo.

4. The Court was without authority to transfer petitioner's proceeding from Division 15, which heard the case, to Division 11 for the determination thereof, without petitioner's knowledge or consent, the incumbent of Division 15 having been at all material times functioning and serving as a Judge of said Tax Court.

5. The Court erred in holding that the Commissioner of Internal Revenue has the power, under Section 23(a)(1)(A), I.R.C., to disallow in part, solely on the grounds of excessiveness or unreasonableness, salaries actually paid during the taxable year 1942, to petitioner's two managing officers, pursuant to previous corporate authorization therefor, for services actually performed by them.

6. If, under Section 23(a)(1)(A), I.R.C., respondent had authority to exercise visitatorial power over salary payments, through the medium of disallowing part of the payments actually made, the Court erred in finding that "a reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner \* \* \* during the year 1942 was \$10,000 per annum for each".

7. The Court erred in holding that \$18,000 of the full amount of \$28,000 each, paid by petitioner to Cunningham and Morse during 1942, for their services, was excessive and unreasonable.

8. The Court erred in rejecting (in its memorandum opinion) as unimpressive, the uncontradicted testimony of Cunningham which established that petitioner would have had to pay more than \$28,000 if it had hired others to do the work performed by Cunningham in 1942.

9. The Court erred in holding and concluding that the evidence presented "indicates a studied plan to anticipate profits to be earned and distribute them in the guise of compensation rather than as dividends", inasmuch as no such issue was presented by the pleadings, either in their original form or as

amended, and respondent had not assigned any such contention in his deficiency determination.

10. The Court erred in failing to find all of the facts as stipulated by the parties.

11. The Court erred in failing to follow and apply its own Rules, Nos. 35 and 35(b), in arriving at its findings of facts herein, e.g., under petitioner's statement of facts, Paragraph No. 19, which was accepted by respondent in his brief by operation of the provisions of Rule 35, it clearly appeared, without any contradiction in the evidence, that as to Cunningham more than \$42,000 would have had to be paid to others by petitioner if it had been required to hire others to perform the services which he rendered for it in 1942.

12. The Court erred in failing to find and hold that the amounts of \$28,000 paid to each, Cunningham and Morse, as compensation for services rendered in 1942, represented reasonable compensation and was, therefore, properly deducted by petitioner.

13. The Court erred in that while it held that the equality of compensation paid to Messrs. Cunningham and Morse was inconsistent with an intention to compensate them on the basis of the value of their respective services, it nevertheless found and concluded that the value of the services of each for 1942 was equal in amount, namely, \$10,000.

Wherefore, your petitioner prays that this Honorable Court may review the decision and order of, and all of the proceedings heretofore had, before the Tax Court of the United States to the end that the

errors and omissions of the Tax Court of the United States may be corrected; that the Tax Court's decision of the findings and conclusions be reviewed and set aside; that the Tax Court be directed to enter an order, in the above entitled cause, of "No Deficiency" under the evidence, or to grant an entirely new hearing; and for the entry of such further orders and directions as shall by this Court be deemed meet and proper, in accordance with law.

WALTS, INC.,  
Petitioner.

By /s/ GEO. H. ZEUTZIUS,

By /s/ A. P. G. STEFFES,

Attorneys for Petitioner.

State of California,  
County of Los Angeles—ss.

Geo. Zeutzius, being duly sworn, says:

I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. The petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 2nd day of July, 1947.

(Seal) /s/ A. P. G. STEFFES,

Notary Public in and for said County and State.

[Endorsed]: T.C.U.S. Filed July 7, 1947.

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW  
AND ACCEPTANCE OF SERVICE  
THEREOF

To Commissioner of Internal Revenue, Internal Revenue Building, Washington, D. C., and Chief Counsel for Bureau of Internal Revenue, Attorney for Respondent, Internal Revenue Building, Washington, D. C.:

You Are Hereby Notified that on the 7th day of July, 1947, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States, heretofore rendered in the above-entitled cause, was filed with the Clerk of said Court.

A copy of the petition, as filed, is attached hereto and served upon you.

Dated July 7th, 1947.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

(Acknowledgment of Service.)

[Endorsed]: T.C.U.S. Filed July 8, 1947.

In the United States Circuit Court of Appeals  
For the Ninth Circuit

Docket No. 6974

WALTS, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

STIPULATION FOR EXTENSION OF TIME  
TO FILE CERTIFIED RECORD ON RE-  
VIEW AND ORDER THEREON

It Is Hereby Stipulated that petitioner's time within which to file the certified record on review with the Clerk of the above entitled Court may be extended to and including December 15, 1947, for the following reasons:

Certain negotiations having for their objective the settlement, compromise and payment of all claimed income tax liabilities of petitioner to the Government of the United States, including its income tax liability for the year 1942, which is the subject matter of the petition for review filed by petitioner in these proceedings, certain negotiations are now being carried on between the Technical Staff of the Commissioner of Internal Revenue at Los Angeles and counsel for petitioner, and there is a reasonable probability that as the result of the cooperation between petitioner and respondent a settlement and compromise can be effected. In the event such settlement and compromise is effected, it will be unnecessary to

proceed with the petition for review herein and considerable expense will be saved to petitioner if petitioner is not compelled to file with the Clerk of the above entitled Court the record on review until December 15, 1947.

Dated August 1, 1947.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

/s/ CHARLES OLIPHANT,

Acting Chief Counsel, Bureau of Internal Revenue.

It Is So Ordered this 12th day of August, 1947.

/s/ ALBERT LEE STEPHENS,

Circuit Court Judge.

A True Copy. Attest: Aug. 13, 1947. Paul P. O'Brien, Clerk. By Frank H. Schmidt, Deputy Clerk.

[Endorsed]: Filed Aug. 13, 1947. Paul P. O'Brien, Clerk.

---

[Title of U. S. Court of Appeals and Cause.]

**AFFIDAVIT IN SUPPORT OF REQUEST FOR  
EXTENSION OF TIME TO FILE RECORD  
ON REVIEW**

County of Los Angeles,  
State of California—ss.

Geo. H. Zeutzius, being first duly sworn, deposes and says:

That he is one of the attorneys of record in the



above case and that he has read the attached Stipulation for Extension of Time to File Certified Record on Review, which stipulation has been signed by the Acting Chief Counsel for the Bureau of Internal Revenue at Washington, D. C.; that the statements contained in said stipulation for extension of time are true and are presented to the above entitled Court as a basis for the request contained in said stipulation for an extension of the time until December 15, 1947, within which petitioner may file its certified record on review with the Clerk of the above entitled Court.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 11th day of August, 1947.

/s/ GLORIA WEAVER,  
Notary Public in and for the County of Los Angeles,  
State of California.

My commission expires May 27, 1950.

---

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE  
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the

Clerk of this Court be, and the same hereby is, extended to February 1, 1948.

Dated December 12, 1947.

/s/ ALBERT LEE STEPHENS,  
Circuit Court Judge.

A True Copy. Attest: December 13, 1947, Paul P. O'Brien, Clerk.

[Endorsed]: Filed December 13, 1947. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Dec. 22, 1947.

---

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE RECORD  
ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to April 15, 1948.

Dated January 29, 1948.

FRANCIS A. GARRECHT,  
Circuit Court Judge.

A True Copy. Attest: Jan. 29, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Jan. 29, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed Feb. 3, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE  
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to July 15, 1948.

Dated April 12, 1948.

FRANCIS A. GARRECHT,  
Circuit Court Judge.

A True Copy. Attest: April 13, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Apr. 13, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed April 19, 1948.

---

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE  
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within

which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to October 15, 1948.

Dated July 8, 1948.

/s/ FRANCIS A. GARRECHT,  
Circuit Court Judge.

A True Copy. Attest: July 8, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed July 8, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed July 12, 1948.

---

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE  
RECORD ON REVIEW

Upon the application of counsel for petitioner, and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within which to file the certified record on review with the Clerk of this Court be, and the same hereby is, extended to December 15, 1948.

Dated October 13, 1948.

WILLIAM DENMAN,  
Chief Judge, U. S. Court of Appeals for the Ninth  
Circuit.

A True Copy. Attest: October 13, 1948. Signed Paul P. O'Brien, Clerk.

[Endorsed]: Filed Oct. 13, 1948. Paul P. O'Brien, Clerk.

[Endorsed]: T.C.U.S. Filed Oct. 18, 1948.

[Title of U. S. Court of Appeals and Cause.]

ORDER EXTENDING TIME TO FILE  
RECORD ON REVIEW

Upon the application of counsel for petitioner,  
and good cause appearing therefor:

It Is Hereby Ordered that petitioner's time within  
which to file the certified record on review with the  
Clerk of this Court be, and the same hereby is,  
extended to January 1, 1949.

Dated December 14, 1948.

WILLIAM DENMAN,

Chief Judge, U. S. Court of Appeals for the Ninth  
Circuit.

A True Copy. Attest: Dec. 14, 1948. Signed Paul  
P. O'Brien, Clerk.

[Endorsed]: Filed Dec. 14, 1948. Paul P. O'Brien,  
Clerk.

[Endorsed]: T.C.U.S. Filed Dec. 20, 1948.

---

The Tax Court of the United States

Docket No. 6974

[Title of Cause.]

DESIGNATION OF CONTENTS OF RECORD  
ON REVIEW

To the Clerk of the Tax Court of the United States:

Petitioner, Walts, Inc., being also the petitioner on  
review, hereby designates for inclusion in the record  
for consideration by the United States Court of

Appeals for the Ninth Circuit on review of the decision of the Tax Court of the United States, the entire original files and proceedings in the above-entitled case, including the following:

1. Docket entries.
2. Petition (with annexed deficiency notice) and amendment to petition.
3. Answer and answer to amendment to petition.
4. The reporter's transcript of all proceedings before the Tax Court, together with all exhibits introduced in evidence at the hearing before the Tax Court. (Note: A thirteen-page Stipulation of Facts was filed with the Tax Court during the trial and so marked. It had attached thereto as part thereof joint Exhibits 1-A to 9-I, inclusive. During the Tax Court hearing, the only additional exhibits introduced were marked as Petitioner's Exhibits 10 and 11 and Respondent's Exhibits J, K, L, M and N.)
5. The above-mentioned Stipulation of Facts with its attached Exhibits 1-A to 9-I, inclusive.
6. Memorandum findings of fact and opinion.
7. Motion for rehearing de novo and order of February 17, 1947 of Judge Harlan denying motion.
8. Decision of the Tax Court entered April 10, 1947.
9. Motion to correct said decision, filed April 18, 1947, and order of April 21, 1947 denying motion.
10. Respondent's computation for entry of deci-

sion, together with its accompanying computation, filed March 10, 1947.

11. Petition for review by the United States Court of Appeals for the Ninth Circuit.

12. Notice of filing petition for review and acceptance of service thereof.

13. Stipulation dated August 1, 1947 for extension of time to December 15, 1947, in which to file certified record on review and order thereon of August 12, 1947, granting said extension.

14. Order entered December 12, 1947 extending time to February 1, 1948 to file record on review.

15. Order entered January 29, 1948 extending time to April 15, 1948 to file record on review.

16. Order entered April 12, 1948, extending time to July 15, 1948 to file record on review.

17. Order entered July 8, 1948, extending time to October 15, 1948 to file record on review.

18. Order entered October 13, 1948, extending time to December 15, 1948 to file record on review.

19. Order entered December 14, 1948, extending time to January 1, 1949 to file record on review.

20. This designation of contents of record on review, together with acknowledgment of service by respondent and any stipulation appended thereto.

Request is hereby made that said record be certified and transmitted by the Clerk of the Tax Court of the United States to the Clerk of the United

States Court of Appeals for the Ninth Circuit, as required by law and the rules of said Court of Appeals, and particularly its Rule 11, as amended, effective January 1, 1949.

Dated December 22, 1948.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Counsel for Petitioner.

Personal service of a copy of the foregoing Designation is hereby acknowledged as having been made this 27th day of December, 1948.

/s/ CHARLES OLIPHANT,

Chief Counsel for the Bureau of Internal Revenue.

It Is Hereby Stipulated that the foregoing designation contains a designation of the entire record and proceedings in the case and respondent hereby waives the right under Rule 75(a) of the Federal Rules of Civil Procedure to designate additional portions of the record on review in the above-entitled case.

Dated December 27, 1948.

/s/ CHARLES OLIPHANT,

Chief Counsel for the Bureau of Internal Revenue,  
Counsel for Respondent.

[Endorsed]: T.C.U.S. Filed Dec. 27, 1948.



The Tax Court of the United States  
Washington

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 29, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Stipulated Designations of Contents of Record on Review" in the proceeding before The Tax Court of the United States entitled "Walts, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent", Docket No. 6974 and in which the petitioner in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 31st day of December, 1948.

(Seal)            /s/ VICTOR S. MERSCH,  
Clerk, The Tax Court of the United States.

Before The Tax Court of the United States

Docket No. 6974

In the matter of: *Walts, Inc.*, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Room 229, United States Post Office and  
Court House Building,

Los Angeles, California

June 18, 1946—9:30 a.m.

(Met pursuant to notice.)

Before: Honorable Eugene Black, Judge.

Appearances: Zeutzius & Steffes, By George H. Zeutzius, Esq., 510 South Spring Street, Los Angeles, California, appearing on behalf of *Walts, Inc.*, Petitioner. W. J. McFarland, Esq., (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent. [1\*]

### PROCEEDINGS

The Clerk: 6974, *Walts, Incorporated*.

The Court: Are you ready in the *Walts, Incorporated*, case?

Mr. Zeutzius: Ready.

Mr. McFarland: Ready for the respondent.

The Court: Will you state the appearances for the petitioner?

Mr. Zeutzius: For the petitioner, George H. Zeutzius, and my partner, who is not present in court this morning, P. G. Steffes. We appear of record

---

\* Page numbering appearing at foot of page of original certified Reporter's Transcript.

as counsel. I happen to be here alone this morning, without him. He is out of the city for the day.

Mr. McFarland: W. J. McFarland for the respondent.

The Court: Very well. Petitioner's counsel may make an opening statement of the issues in the case.

\* \* \* \*

Mr. Zeutzius: Now the stipulation of fact signed by the parties, I take it, will have to be offered in evidence.

The Court: Yes, that is right.

Mr. Zeutzius: So the stipulation as offered, having in mind that normally I would first confine the evidence to the first point and have it determined, but in view of what has transpired here I shall just offer the entire stipulation.

The Court: Yes. It does not have the effect of waiving your contention on the first point. The stipulation of facts will be received in evidence.

Mr. Zeutzius: It is a joint exhibit.

The Court: Yes, the stipulation of facts, together with the exhibits attached thereto, is received in evidence.

Mr. Zeutzius: In order to round out with reference to the stipulation certain other of the statements in the stipulation, I would like to ask Mr. McFarland at this time if he has the originals of the 1940, 1941 and 1942 income tax returns of the petitioner.

Mr. McFarland: I do not have the originals of the 1940, if the court please. I have the original 1941 corporation income declared value excess profits tax return, and I have the corporation 1942 income

declared value and [15] excess profits tax return, which I will offer in evidence at the proper time.

Mr. Zeutzius: Would it be permissible for counsel to offer them out of turn? I might like to use them.

Mr. McFarland: Whichever the court wishes.

The Court: Well, the respondent can now offer them as his Exhibits A and B. Suppose you offer the corporation's declared value income tax return and declared value excess profits return for 1941 as Respondent's Exhibit A.

Mr. McFarland: Well, if the court please, we have exhibits in the stipulation that run from A to I. Can this be Respondent's Exhibit J?

The Court: Yes, I think we better make it Respondent's Exhibit J.

It will be received as Respondent's Exhibit J.

(The return referred to was marked and received in evidence as Respondent's Exhibit J.)

Mr. McFarland: That is the 1941 corporation income declared value excess profits tax return of Walts, Incorporated. As Respondent's Exhibit K, the 1942 corporation income declared value excess profits tax tentative return and final corporation income and declared value excess profits tax return, together with the corporation excess profits tax return for the same year. [16]

The Court: It will be received in evidence as Respondent's Exhibit K.

(The return referred to was marked and received in evidence as Respondent's Exhibit K.)

Mr. McFarland: If the court please, before we start in on the evidence, I should like to have a rule excluding the witnesses from the court room.

The Court: Are there any witnesses in the court room? Of course, the petitioner himself has a right to be present.

Mr. McFarland: That would be an officer.

The Court: Yes, I mean the officers.

Mr. Zeutzius: We have two officers and no other witnesses here now.

The Court: The president, and who is the other officer?

Mr. Zeutzius: A director, who is a director during this period.

The Court: Well, I should think if the respondent insists on his exclusion, that only the president should be permitted to remain and the director would not be.

Mr. Zeutzius: Well, the evidence of the director will be very brief.

The Court: Yes, I know, but I think if the respondent insists on the rule that the only officer that would [17] be regarded as necessary in the case to remain in the court room would be the president.

Mr. Zeutzius: May I say this, the director, I believe, is also a vice-president, and she is directly interested because fees were paid to that director as a director for services, just like——

The Court: That is not in the case. I will rule if the respondent insists that the director be excluded, that the director would have to be excluded and the president remain to advise counsel.

Mr. Zeutzius: Well, may the petitioner note an exception to your Honor's ruling?

The Court: Yes. Is the director in the room at present?

Mr. Zeutzius: Yes.

The Court: She may retire, and Mr. Tonjes, can you direct her to some suitable place to remain?

Mr. Zeutzius: Let the record show—

Mr. Tonjes: I don't know any except your Honor's chambers.

The Court: That will be all right. She may have a seat in there.

Mr. Zeutzius: The director in question and vice-president is Mrs. Cunningham.

The Court: Yes. [18]

Mr. Zeutzius: Will counsel furnish the petitioner with photostatic copies of the 1941 and 1942 returns just offered?

Mr. McFarland: I make the motion, if the court please, that I be allowed to substitute photostats and withdraw the originals of the exhibits.

The Court: Yes, you may have that permission.

Mr. Zeutzius: In connection with what I understood, counsel had agreed upon in the event of the 1940 return of the petitioner, income tax return not reaching the court before the trial, that petitioner might offer petitioner's retained copy of the 1940 income declared value and excess profits tax return with the understanding that the court would be asked for permission to permit its withdrawal and substitution of photostats—

Mr. McFarland: And also I should like, I have requisitioned the original from Washington, and I

believe we agreed that if the original does not conform to the copy in any respect we will substitute the original. Is that understood?

The Court: Yes, that agreement may be understood. And the document you wish now to offer in evidence, do you, Mr. Zeutzius?

Mr. Zeutzius: Yes, your Honor.

The Court: It will be received in evidence as [19] Petitioner's Exhibit 10, and permission is granted to substitute photostatic copy.

(The return referred to was marked and received in evidence as Petitioner's Exhibit No. 10.)

Mr. Zeutzius: I would like to ask counsel at this time if he has obtained a collector's transcript concerning the taxes paid for 1940, 1941 and 1942, in accordance with our oral understanding.

Mr. McFarland: No, I have not. I have ordered it and it is in the process of being either made up or being sent. When it is available, I will gladly show it to counsel.

The Court: You want to offer it in evidence?

Mr. McFarland: I believe not. I do not believe it is a part of the record, if the court please. It is merely a statement from the Collector's office showing the various payments on the various taxes as reported by the petitioner corporation, and as I understand it, the payments on the amount that was paid is not an issue here.

The Court: What would be the object of introducing it?

Mr. Zeutzius: In connection with the whole picture, your Honor. We asked it to appear not only

what was the gross income or the gross sales and net income, but what taxes were paid. I think it is very important as bearing [20] upon the entire picture. Here is the thing, what taxes did the petitioner pay?

Mr. McFarland: No, I don't think that it is at all pertinent to the issue which is to be heard right now, if the Court please.

Mr. Zeutzius: In most of the cases on the salary question it is indicated in the opinion what taxes were paid for several years, the year in question and other years.

The Court: I can't see how that would be material at all to the question whether the salaries are reasonable. I remember many decided cases, but I don't recall any of them where that question was deemed to be involved.

Mr. Zeutzius: Well, I would like to ask counsel for the government to produce the refund claim filed for 1941 and 1942, the originals thereof, by petitioner.

Mr. McFarland: If the Court please, there was no notice on me to produce, and I don't believe I had them.

Mr. Zeutzius: You had them in your office a week ago, you recall, and on the back of the claim is the certificate by the Collector.

Mr. McFarland: I don't have them here.

Mr. Zeutzius: As to the payments made.

Mr. McFarland: I don't have them here, if the Court please, and furthermore I don't see the materiality of it or that it goes to prove a single evidentiary or [21] ultimate fact.



The Court: In this case there is no claim of an overpayment, is there?

Mr. McFarland: No claim.

Mr. Zeutzius: Your Honor, there is \$130.00 determined as the result of a juggling of all the figures, due to action taken by the Commissioner, and it may well be that if the Commissioner were to be sustained there would be a \$130.00 overpayment for which we should be allowed credit.

The Court: Well, that is not an issue before us, however, as he has allowed it in the deficiency notice and we have no jurisdiction over assessments at all. The only thing that is involved in this case is whether or not the taxpayer is to be held liable for a declared value excess profits tax deficiency, the excess profits tax deficiencies which are named in the deficiency notice. Now, those deficiencies, as I understand it, are due altogether to the Commissioner's disallowance of parts of the salaries paid to the two officers of the petitioner, to-wit, Mr. Cunningham and Mr. Morse. That is the issue that we have. If the Court should sustain the petitioner in its claim that the salaries were reasonable, then as I understand it, there will be no deficiency. On the other hand, if we should not sustain the petitioner or we sustain it in part, then there would be a deficiency. Now, I can't see the relevancy of [22] any claim for a refund.

Mr. Zeutzius: Your Honor, I was anxious, of course, to include the thousand-dollar item for fees to directors.

The Court: Yes, I understand that.

Mr. McFarland: They are not an issue, if the Court please.

Mr. Zeutzius: We think, however, that as a part of the showing of the progress and success of the corporation and that officers, the particular ones were responsible for that growth, that we are entitled to show, especially where the incorporation is so close in proximity of time to the taxable year, namely, something like a year and a half, we are entitled to show what was the result of its operations in 1940, '41 and '42 for comparison.

The Court: Well, I think you may show that.

Mr. Zeutzius: In that connection we would like the Court to know anything we are entitled to show what taxes they paid.

The Court: No, I don't think that would be material, but it is all right for you to show the progress of the company, for example, the business done in 1940, the business done in 1941 and the business done in 1942. The Court will certainly be disposed to allow you to make a full showing, but would rule that it is not material to show what taxes were paid in those years, because we do not have those [23] years before us.

Mr. Zeutzius: May I on behalf of the petitioner make this offer of proof, that if the proof were permitted to go in as shown by the records of the Collector of Internal Revenue at Los Angeles, that for 1940 petitioner would be shown to have paid—no, there would be no income tax paid for 1940, no declared value excess profits tax, and no excess profits tax paid by the Commissioner for 1940.

Mr. McFarland: Paid by the Commissioner?

Mr. Zeutzius: I mean by the petitioner, I am

sorry. Nothing was paid in 1940, our proof would show. We so offer to make that proffer.

We would proffer to show that the rejected evidence would disclose that petitioner paid \$641.32 in income tax to the Collector, being the amount of liability reported on its 1941 return which is in evidence. For 1942 we proffer to show by the rejected evidence that the petitioner paid total taxes to the Collector of \$23,001.75, consisting of an income tax of \$1,504.48 as shown in the last return which is in evidence, and \$21,497.27 excess profits tax, as shown by its return also in evidence.

The Court: Very well. The record will show your proffered evidence and respondent files his objection to it as immaterial, which objection is sustained, and the offer of the petitioner is denied. [24]

Mr. Zeutzius: Now, with respect to Paragraphs 1 and 2 of the petition, that has been admitted by the answer, and I would like to see counsel's revised answer which was just filed this morning. Is my understanding correct, your Honor, that where the pleadings contain admissions it is not necessary in the Tax Court's practice to read in evidence the admissions?

The Court: That is right. If the answer, as it usually does, admits certain things, those are no longer an issue and no evidence need be offered.

Mr. McFarland: Counsel has reference to the 90-day letter.

Mr. Zeutzius: The first two paragraphs have not been amended, are just as petitioner filed them. We are going to offer them with the exhibits as attached, copies of the documents attached there to the petition. It is a true copy.

Mr. McFarland: We have admitted them.

The Court: Yes, that is all admitted.

Mr. Zeutzius: One more point I had. We produce to counsel checks aggregating a thousand dollars, representing the directors' fees paid during the period subsequent to the August 14, 1942, meeting at which the payment of directors' fees was authorized by a corporate resolution of the petitioner, as shown by the stipulation of facts in [25] evidence. Does counsel wish to examine the checks?

Mr. McFarland: I would like very much to, yes.

Mr. Zeutzius: While counsel is examining the checks, does the Court wish me to proceed?

The Court: Yes, you may proceed, because if you wish to introduce the checks, that can be done.

Mr. Zeutzius: Will you take the stand, Mr. Cunningham?

#### Evidence on Behalf of Petitioner

Thereupon, the petitioner, to maintain the averments of its petition, introduced the following proof:

Whereupon:

WALTER JAMES CUNNINGHAM,  
called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Zeutzius:

Q. Your name is Walter James Cunningham?

A. That is correct.

Q. What is your age? A. 48.

Q. Where were you born?

A. Buffalo, New York.

(Testimony of W. J. Cunningham.)

Q. For how long did you live in Buffalo? [26]

A. Approximately eight years.

Q. Where did you then go?

A. Moved from there to Rochester, New York.

Q. And with whom?           A. With my family.

Q. And you mean by that—

A. My mother and father and sisters.

Q. Where did you receive your education?

A. Public school, high school, graduated from high school, and two years of business college.

Q. What high school?

A. West High School, Rochester, New York.

Q. And your business education was also received in Rochester?

A. Also received at the Rochester Business Institute, and after that took a year at Williams, which is an advanced school for business training.

Q. Were you offered any further educational privilege?

A. Yes, I was offered a scholarship at Colgate University.

Q. Did you accept?           A. No, I did not.

Q. Why not?

A. Well, by reason of the fact that the war had started and I enlisted a week after war was declared.

Q. Do you mean the war which started in 1917?

A. That is correct, yes.

Q. How long did you serve in the war?

A. 18 months, a year in this country and eight months overseas.

Q. And in what branch of the service did you function overseas?

(Testimony of W. J. Cunningham.)

A. Machine gunner, 106th Machine Gun Battalion, and after that we were the 102nd Supply Train.

Q. Did there come a time when you were discharged?      A. Yes, sir.

Q. Honorably?

A. Honorably discharged, yes. I have a discharge paper here.

Q. When?

A. I believe that was in '19, about February, 1919.

Q. What did you do after you were discharged?

A. Well, I took a job first thing with the Travelers Insurance Company as a claim adjuster.

Q. How long did you hold that job?

A. Oh, approximately a year.

Q. And then?

A. And then following that my father, who had been engaged in the lumber business for a period of many years, wholesale lumber business, I entered into an arrangement [28] with him. Incidentally, I was the fourth generation in the lumber business at that time.

Q. Of your family?

A. Of my family back.

Q. When did you enter this lumber business?

A. Well, I entered about 1920.

Q. How long did you remain there?

A. From 1920 until 1935, 15 years.

Q. What was your position with the—what was the name of the lumber company?

A. J. P. Cunningham Lumber Company, Inc.

Mr. McFarland: Where was that located?

(Testimony of W. J. Cunningham.)

The Witness: It was located in Rochester, New York.

By Mr. Zeutzius:

Q. What territory did this business cover?

A. Well, the central part of New York State, the main office in Rochester. But we did quite a bit of logging operations throughout the state, travelling saw mills. We cut second-growth timber, including white pine, second-growth white pine and hardwoods, at that time there were considerable quantities of maple, beech, and birch, ash, and so on, which in turn we supplied to the furniture factories and various other types of various other manufacturing industries, and I handled the sales and I helped supervise the [29] cutting of the timber along with shipping, incidentally, all of the crating of the material, followed and supervised all the shipments to these various manufacturing companies.

Q. Did you have any official position with the company?

A. I was secretary and treasurer of the company and a director.

Q. Over what period of time?

A. From the time about a year after I entered the business, that would be about from 1921 or approximately 1922, up until the end of the business.

Q. What compensation did you receive during those years?

A. Well, approximately anywhere from a salary of 12 to 15 thousand dollars a year, in that particular end of it, of course afterwards, shortly after I entered the business in the wholesale end I opened

(Testimony of W. J. Cunningham.)

up a retail yard, it was approximately two years after I had started in the business, which would bring us up to 1922 or 1923. Previously to that time it was wholesale. Then from wholesaling we got to retailing, and we had about ten of them.

Q. In addition to your 12 to 15 thousand dollars a year salary, what other income did you receive from the business?

A. Director's fees of \$25.00 for each and every [30] meeting.

Q. Was that the custom throughout your connection with it?

A. That was the custom throughout my connection with the company, always has been.

Q. Now, in addition to director's fees, what, if anything, did you receive by way of income from that company? Did you ever receive any dividends?

A. Dividends, yes.

Q. Did you receive any outside compensation during that same period in addition to the 12 to 15 thousand dollars and dividends?

A. Yes, I did. I was the commissioner for \$20,000,000 worth of sewer work, handling the awarding of contracts, checking the engineers' fees and the services of the engineers and the bids and the certificates of acceptance to the bank which held the funds of the township where this work was being put in, plus rendering personal services and so on.

Q. Where was this project?

A. This was in the City of Rochester, New York, and adjacent.

Q. Over approximately what years?



(Testimony of W. J. Cunningham.)

A. That would be approximately from 1924 to 1927, approximately three or four years. [31]

Q. Did they complete the project?

A. I completed the project and closed successfully, yes.

Q. What compensation did you get for that?

A. Well, I received a fee which amounted to approximately \$2,500.00 a year for the services.

Q. Now, in connection with your duties with the lumber company in that 15-year period of which you spoke, did you meet anybody that you might include in the manufacturing or business world of prominence?

A. Well, I knew everyone of prominence in the area, politically and in business. I was close to the Bausch & Lomb people, Carl Bausch, I was a close friend of Taylor of the Taylor Instrument Company, Limited. Included as one of my very good friends was the governor of the state, Al Smith, and any number of public leaders and business people. I was very active politically at one time, myself, having been county committeeman, executive committeeman.

Q. What was your contact with the foundries of which you spoke?

A. Well, we specialized in a particular type of flask lumber for them that we cut to size, in other words, there were about 15 different pieces that we cut particularly to size for flasks, and bottom boards and things of that nature for foundry work, specialized in it. We specialized in [32] pattern pine and certain types of crating lumber and heavy tim-

(Testimony of W. J. Cunningham.)

bers for people like the Baldwin Locomotive Works, and we specialized in certain types of mill work from retail yards and dealt in building supplies for building apartments and things of that sort and houses.

Q. With respect to your duties in connection with the foundry people and the type of people that you just mentioned in your last answer, what was the extent of your duties insofar as acquiring knowledge of these businesses that you visited?

A. The extent of my duties?

Q. Give us something concerning whether or not your duties were such as to enable you to learn anything concerning the foundry, pattern and other businesses.

A. Well, naturally my contacts were very close to patterns and foundries, at that time, as I stated before, I had occasion to meet not only the mechanics employed there, but I was asked on many occasions by the owners of the businesses for some advice. I very often went two or three times a week or more to the foundries and pattern shops and allied industries, so I had an opportunity to get knowledge of what was being performed in those various places.

Q. What was the extent of your travels while with the lumber company?

A. Well, I had occasion during many times to make [33] trips out on this coast to purchase material, lumber, from companies like Weyerhaeuser's, and various other big lumber concerns for our uses back East. As a matter of fact, our principal source of supply at that time for lumber for framing mater-

(Testimony of W. J. Cunningham.)

ial was Pennsylvania Hemlock and that supply was becoming limited due to the fact that, well, they were just cutting all the timber off, so there was nothing left, so our supply consisted mainly of West Coast material.

Q. Now, did the lumber business remain good at all times?

A. Well, we had a reorganization in 1932, we went through Section 77-b of the Bankruptcy Law, which I more or less sold everything that I owned to get cash sufficient for and hypothecated my insurance policies to acquire the corporation at that time which it was not necessary for me to do, but I did it.

Q. All the bills were paid?

A. All the bills were paid, everybody was paid.

Q. 100 cents on the dollar?

A. No, no, we settled for 75 cents on the dollar.

Mr. McFarland: If the Court please, the best evidence of all this is the record in the bankruptcy proceeding rather than counsel's recollection or the witness' recollection.

The Court: I understand. This is just background. It could be better evidence, of course, I agree with that.

Mr. McFarland: I think counsel ought to be cautioned also not to ask leading questions, too.

The Court: Yes, don't lead your witness. You may proceed.

The Witness: I might state, if I may, that during these periods of time I was offered many corporation positions and jobs with several companies. One of them was the Edison Portland Cement Company. Their main office is in Philadelphia.

(Testimony of W. J. Cunningham.)

Mr. McFarland: I object and ask the answer be stricken. There is no question before the witness at this time, if the court please.

The Court: Oh, well, he may complete the answer that he has started, background testimony, as I understand it.

The Witness: And further than that, a contractor who was doing approximately 40 to 50 million dollars' worth of state work a year had offered me a position at approximately the same amount for more or less of a sales promotion man, we might say.

Q. (By Mr. Zeutzius): With what company was this?

A. That is the Oliver Cost Construction Company, the other was the Edison Portland Cement Company at Philadelphia, and [35] the sales manager's name was McKelvy, if you would like to check that up, for the one, and the other company was Oliver Cost, himself, who passed away about eight years ago and died leaving an estate of about \$12,000,000.00.

Q. What compensation had you been offered by each of those?

A. Each and every case I was offered approximately \$25,000.00 a year and all my expenses in traveling and otherwise, entertainment and so on, which was customary in those days.

Q. When did that approximately occur?

A. That occurred approximately between the years 1924 to 1929, but I didn't like the position because it entailed more or less drinking and spoiled

(Testimony of W. J. Cunningham.)

my home life. I have been married 26 years and I would like to continue to be married for a number of years more, so for that reason I didn't care for these particular jobs, and I preferred to stay in business.

Q. Did you meet anyone at any time connected with the Aluminum Company of America?

A. Yes. I, of course, had done a considerable amount of business with the Gulf Refining Company of Pittsburgh and had met Dick Mellon and a number of the people, all the engineers around, supplied them with all their materials for building a big plant at Cleveland, Ohio, down in the flats. [36] I handled approximately a hundred thousand dollars a year for the Gulf Refining Company and through the Gulf I had met Dick Mellon and a number of people connected with the ALCOA and had very fine connections in there.

Q. To summarize, during the period 1920 to 1925, what is your recollection as to your earnings from all sources during the peak years?

A. I would say approximately around \$25,000.00 a year average.

Q. You mentioned you were married. How many children did you have or do you have?

A. I was married in 1920. June, I will be married 26 years, that is this June. We have three children.

Q. Is the vice-president who was excused from the room this morning your wife, Mrs. Cunningham?  
A. That is correct.

(Testimony of W. J. Cunningham.)

Q. Was the name of the Bausch & Lomb Optical Company mentioned by you earlier?

A. Yes, it was. Carl Bausch, one of the owners of the company, his grandfather founded the business, is a neighbor of mine on Lake Ontario at our summer home. Ray Taylor was a neighbor on the other side.

Q. Did you ever discuss the matter of employment with that company?

A. Yes. They voluntarily came to me and offered me [37] employment at both plants, with the Bausch & Lomb Company and with the Taylor Instrument Company.

Q. Was any amount of compensation discussed?

A. No, but I would judge it would have been a fairly substantial amount. I never questioned it, because I was not interested at the time.

Q. When was that?

A. That was along about 1935, before I came out on this coast. I came out here in 1936, been out here ten years this October.

Q. When you came out here, what did you do?

A. I engaged in, took a position to keep busy at the lumber business temporarily until I could get myself located, and tried to renew some of the contacts that I had out here.

Q. Did there come a time when you met out here Withers and Ruzzamenti, referred to in the stipulation of facts?

A. Yes, sir. Well, during the time I was employed with the lumber companies, it so happened I made a call when this Westwood Ice Rink was being

(Testimony of W. J. Cunningham.)

formed out here. A man by the name of J. Frank Ruppenthal was promoting the rink. I had seen this man and talked with him quite a bit about building and general housing, and we became very friendly, and it was out there that I met Mr. Withers and Muretta and various other people connected with the undertaking, J. F. C. O'Connor, I guess he is a judge now, was one man I met in [38] this connection who handled this case for Ruppenthal afterwards, endeavoring to straighten things out. Incidentally, they had involved about \$135,000 in that case, approximately \$65,000 was with one financial interest, and I worked many months with Ruppenthal through J. F. C. O'Connor's office endeavoring to straighten the matter out for him. As a matter of fact, the suggestion was made by J. F. C. O'Connor that I take over the actual operation of it and so on, and it was during this time that I met Withers and Muretta—what the devil was the name of the corporation? I am sorry. I don't know the name of the company.

Mr. McFarland: In Westwood?

The Witness: Westwood Village.

Mr. Zeutzius: Yes.

The Witness: It was this new ice rink. I can't think of the name of it now. It is the ice rink in Westwood Village, the one Sonja Heinie played in, and they made many attempts to try to sell it to her or her agent, the same thing. She just took it in the last few months. I contacted him many times trying to sell the rink through him, but was not quite successful with him.

(Testimony of W. J. Cunningham.)

By Mr. Zeutzius:

Q. In connection with Withers, was there any conversation between you?

A. Well, the conversation veered around, we had had [39] several talks on various other affairs and he told me about having some foundry equipment, where he had loaned some money to some people and they were unsuccessful in operating the business, and he wanted to know if I had any knowledge of the foundry business, what I thought of it and so on. I told him I had some knowledge of the foundry business due to my calls on them for many years, and we discussed the matter pro and con, and we decided then, or he requested that I go and take a look at this foundry equipment and the location of it and so on, and I went over into Culver City where the equipment was located and we looked it all over, and I made the suggestion then if the environment was different, the location of the foundry were in an industrial section, it was set up properly with a capitalization of approximately a thousand dollars, that we could possibly make a successful venture out of it within a couple of years, having in mind some things I knew about that Withers didn't know about, I mean I told him about it, about all we needed was a licensing agreement and we were ready to go, in a way.

Q. Did you inspect the foundry equipment with Withers?           A. I did.

Q. Where did you inspect it?



(Testimony of W. J. Cunningham.)

A. At Culver City. It was located in back of these two fellows' place, their home there where they were operating. [40]

Q. Was the equipment thereafter acquired by the petitioner?

A. It was, yes, and moved to a new location which we found.

Q. Is that the same equipment described in Paragraph 3 of the stipulation in evidence, being of the fair value of \$600.00?

A. That is right.

Q. Tell us what occurred between you and Withers after you had visited the foundry equipment, by way of creating the petitioner.

A. We decided to form a corporation, and Withers informed me that he had an attorney by the name of Bernard Laven whom I had never met, who handled Jane Withers' Affairs, the little picture actress, and that he could satisfactorily handle it, which I concluded, too, and we went down to his office and went into the details of the matter. A corporation was formed and naturally Mrs. Cunningham put in an equal amount with Withers.

Q. How much did Mrs. Cunningham put in the corporation?      A. I believe \$500.00.

Q. What did she receive for it?

A. I think it consisted of 25 shares of stock, if I remember correctly. [41]

Mr. McFarland: This is all set out in the stipulation, if the court please.

Mr. Zeutzius: Yes. I think the stipulation states 50 shares.

(Testimony of W. J. Cunningham.)

Mr. McFarland: Yes. We are not relying just on his recollection. I submit that this is not necessary.

The Witness: Yes, it is about 50 shares, approximately. I was not a stockholder at any time.

By Mr. Zeutzius:

Q. Did you put any money in at that time?

A. No, I did not.

Q. How much did Mr. Withers put in?

A. The same amount, \$500.00, plus the equipment.

Q. Now, who were employed after the corporation was organized in April, 1942?

A. Well, these people called the Ruzzamentis. There was the father and two sons.

Mr. McFarland: The corporation was organized in 1940, if the court please, not 1942.

Mr. Zeutzius: Counsel, you are correct. That is my error.

The Witness: There was John and Alex and another son; I can't quite recall the other boy's name.

By Mr. Zeutzius:

Q. What was the location of the equipment at that [42] time?           A. On Slauson Avenue.

Q. What did you do at that time with reference to the corporation?

A. Well, at that time after the corporation was set up, the papers being drawn, I found a location up and install the various utilities there to get it in shape to operate and made the deposits for the

(Testimony of W. J. Cunningham.)

various utility companies, in general, electrical work and water and so on, in other words, getting the building set up in shape to do business, and in the meantime during that time I was formulating and figuring out patterns which might enter in the line, brass iron andirons and other articles that we could make in there, plus some aluminum work that we were contemplating doing. We had an order—or later on, that comes into it later on, we had an order from a company called the Phone Company for making 10,000 of these little play-tune things you see in the Thrifty Drug Stores, \$1.18 apiece, an \$18,000.00 order.

Q. With respect to the year 1940, what amount of your time did you devote to the business of the petitioner corporation from the date of its incorporation?

A. Well, I put in all of my time, down to 12 and 13 hours a day, endeavoring to get business and to get things started and going, for which I received no compensation [43] whatever, spent my entire summer, as a matter of fact, lived on borrowed money.

Q. You mean during 1940?

A. That is correct, yes.

Q. By the end of 1940 what had you accomplished by way of promoting the petitioner's business?

A. By the end of 1940, well, not so much. I mean, not that I considered a very desirable picture. I mean I had done considerable work and

(Testimony of W. J. Cunningham.)

had formulated, started a lot of things and I had a lot of things, pattern designs, made and had done some business, but not any large amount. It was not entirely satisfactory as far as I was concerned. During that period of time I incidentally was working on this licensing agreement with the Aluminum Company of America, endeavoring to get that straightened out, which without you could not make these various alloys, because ALCOA had patent rights on it, and it was impossible to even buy the alloys unless you had a licensing agreement and paid the royalties on it.

Q. Now, keeping in mind the year 1941, did you draw any salary during that year?      A. 1941?

Q. Yes. You said you drew none in 1940.

A. Oh, I drew, I think, approximately \$1400.00 and some-odd dollars from the corporation in 1941 for salary [44] for the services, yes.

Q. Was the amount paid you authorized by any corporate action?

A. I think so, yes. You asked me the name of that ice rink. It was the Westwood Ice Palace.

Q. What was your position with the company in 1940?

A. I was secretary and treasurer and a director—not a director—a director, yes.

Q. What was your position in 1941?

A. I was, I believe, president of the company in 1941.

Q. And what was your official position in 1942?

A. President of the corporation.

(Testimony of W. J. Cunningham.)

Q. What was your income in 1940 while you were with the company?

Mr. McFarland: I object, if the court please.

The Witness: I received no income.

The Court: I will overrule the objection.

By Mr. Zeutzius:

Q. My question is intended to include income from any source whatever. A. No, sir.

Q. What was your income from any source whatever in 1941?

A. I believe around \$1600.00 from the corporation, I believe was the amount that I got in 1941.

Q. Did you file an income tax return for 1941, so far as you recall? A. I did.

Q. For 1941? A. For 1941, yes.

Q. What was your income——

Mr. Zeutzius: Does counsel have the income tax returns for 1941 of this witness?

Mr. McFarland: They have not come to me.

By Mr. Zeutzius:

Q. What was your income in 1942 from any source whatever?

A. Other than the corporation?

Q. From all sources.

A. \$28,000.00, plus, I believe, \$250.00 in director's fees.

Q. What income taxes did you pay in 1942?

Mr. McFarland: I object.

By Mr. Zeutzius:

Q. On your income?

(Testimony of W. J. Cunningham.)

The Court: Well, you object. What is the purpose of that?

Mr. Zeutzius: I wish to show by this witness that all the income he got barring, I think \$7.00 or something from another source, came from this company as salary and [46] director's fees, and that he paid a certain tax on that.

The Court: Well, of course he did, but I can't see where that is material in this case.

Mr. Zeutzius: Well, it is our contention that in connection with the \$28,000 it was not all clear. He paid a considerable tax.

The Court: Certainly, certainly. You may show that he paid his taxes. I think the amount is irrelevant, because he would pay the same as anybody else in tax on that amount. Of course, you have brought out that point that he received something in excess of \$28,000.00 for the year 1942 and he filed an income tax return and paid taxes on that amount.

Mr. Zeutzius: And that he received no income from any other source.

The Court: Yes, he has testified to that.

The Witness: That is correct.

By Mr. Zeutzius:

Q. Now, in 1941, please state what you did in the performance of service for petitioner?

A. 1941?

Q. 1941, the year prior to the tax year.

A. Well, there was a change. I explained about Withers getting out of the picture. That occurred in 1941, did it not? [47]

(Testimony of W. J. Cunningham.)

Q. When did he get out of the picture in 1941?

A. Some time in March, as I recall, about March of 1941.

Mr. McFarland: We have that in the stipulation of facts, if the court please.

Mr. Zeutzius: That is right, it is shown in the stipulation that Withers withdrew in March.

By Mr. Zeutzius:

Q. And whom did you associate in the enterprise, or who became associated with petitioner upon the retirement of Withers?

A. Elmer D. Morse.

Q. How did he happen to become interested? Will you please tell us if you know.

A. Well, at the time I was negotiating it through J. F. C. O'Connor's office, with some client or friend of J. F. C. by the name of Smith who had married into the Walgreen family, and during the course of that time when they were considering and looking over my data I had the license agreement with ALCOA and they were looking that over and various other proposals, and through a friend of mine I was introduced to Morse, and we arranged a meeting and discussed the business of what I had and so on, and he was very anxious to become associated with me on it. As a matter of fact, I told him about this other arrangement that I had, I thought [48] I would have to take it, I thought, but he was very insistent and he said that he wanted to make this arrangement and that he would like very much for me to make my mind up

(Testimony of W. J. Cunningham.)

to do it right away. So I considered it and thought it all over and finally came to the conclusion that I needed some one of his type who knew that end of the business, that I could not do it alone, and I could not do all the business, from what I had known of similar lines of business, I had to have some one in there that knows how to figure this kind of thing that I had encountered to keep the thing going. Morse had had quite a lot of business experience and I thought he was a good man for it, and we made arrangements whereby he first became the secretary and treasurer of the company, and a director, which was consummated, I believe, in March, some time in 1941, to the best of my recollection, and from that time on our time was devoted entirely to finding a new location, as the aircraft companies and everyone else we did business with insisted that the company be set up to operate and have the men employed before the order would be given out. It had to be done. In other words, an inspection was made, and if the company thought the situation was satisfactory for their purposes, they would give you the go ahead with the purchasing engineer, and they had to be sure if the company took the order that they would be successful in providing many of these items, and if you were [49] able to meet the personnel and chemical requirements of this business, why the order was forthcoming. It was not a very easy job to get it, you might think those orders came easy, but it was not an easy job for a new company to get business



(Testimony of W. J. Cunningham.)

on aircraft parts which involved all these alloys, because, after all, during this time there were only two people that were permitted to use them, ALCOA, which had the patent rights on them and one other company called the Aluminum Alloys, so that it was practically confined to a couple of companies during a period up to about 1940, at which time there were three or four companies like myself who were given this licensing agreement, and in this licensing agreement they specified just how it should be run, specified all the heat-treating process and they provided various and sundry things which had to be determined by an engineer. There was a multitude of things to be done, equipment to be purchased and priorities to be secured. In other words, it was one hell of a hard job to do, I will tell you that frankly.

Q. Now, I wish to go back to the matter of procuring a licensing agreement in a few moments and I would like to carry through on the basis of your present testimony. First of all, what were your duties during 1942?

A. Well, I did practically everything. I did everything. I worked, I did practically all the work there of a [50] metallurgist, I was shipping clerk, I was general manager and practically everything you could think of, as far as the production end of the business was concerned. I did everything. I hired one man, the first man I hired in this building that we found on Boyle Avenue in Vernon, I hired a man who was a carpenter to fix the building up

(Testimony of W. J. Cunningham.)

and tear the partitions down, because we had to move everything to get the utilities in, to get the gas in there and to bring the electricity and the water in, the heat-treating furnaces. The building had formerly been used by a chemist from Hollywood for experimental purposes trying to make synthetic tires and there was stuff all around the place. The building was 40 by 60 feet but later on developed into a building 80 by 165 in length. And those things all had to be done, it is hard to determine, it made a multitude of engineering problems that you can't even think of in connection with starting a new business that was virtually unknown on this coast with the exception, as I said before, of the Aluminum Company of America and Aluminum Alloys.

Q. Where did the company move from the Slauson Avenue property?

A. Moved from Slauson Avenue to a location known as 5511 Boyle Avenue. In other words, Morse took one end of the town of Vernon and I looked at the other end, and we went up and down the streets like that to get a location, and this [51] was the only one in the entire city of Vernon that was available.

Q. What were the duties of Morse during 1942 after his connection with the company had started in 1941?

A. He handled the scheduling, he handled the financial end of the business, he handled the payrolls, he handled the office detail of all sorts and

(Testimony of W. J. Cunningham.)

descriptions, and our duties all overlapped. In other words, two people starting a business, I guess it is to be appreciated that we couldn't just sit down and say "I am going to do this; you're going to do the payroll and books and so on." Our duties overlapped. He handled the office detail and handled the various things that go into scheduling of your parts out of your foundry and so on. In other words, our duties overlapped more or less.

Q. Who handled the financing?

A. Morse.

Q. Who acted as—did the petitioner have an inspector of castings?

A. Yes, I handled that visual inspection on all castings before they were shipped to the aircraft company, and then in turn I also inspected them, the inspectors of the aircraft company inspected them and then another inspection was made when they reached the plant, so that three inspections were made on them before they came out of the [52] plant or into our machine shop.

Q. Do you know what the petitioner would have had to pay as a salary to an inspector of castings in 1942?

Mr. McFarland: I object to that question, if the court please.

Mr. Zeutzius: I think it is perfectly proper for this witness who performed the various duties to say what it would have cost if the petitioner had had to employ somebody else to perform the same job.

(Testimony of W. J. Cunningham.)

The Court: I will overrule that. He may testify.

The Witness: Well, to the best of my knowledge, it would entail a salary from \$350.00 to \$450.00 a month.

By Mr. Zeutzius:

Q. Now, did the petitioner have a superintendent of production?

A. Well, at the start in 1942 I handled the detail of that, yes.

Q. What salary would have been required to be paid if the superintendent of production had been hired by the petitioner?

Mr. McFarland: My objection goes to this entire line of questioning.

The Court: Yes, I understand. The objection is overruled.

The Witness: Well, to the best of my knowledge and [53] belief, I have known of cases of a thousand dollars a month for a good production manager, a man that understood the scheduling of parts for the aircraft industry. You see, we made at the peak of our business down to the end various and different parts of aircraft for North American, Douglas, Vultee. We shipped all of our products all over the country, to various scattered parts, and we had to get those at the scheduled period into the machine shop, and scheduled out, and you had a certain amount of time allowed to do the job.

By Mr. Zeutzius:

Q. Did the petitioner employ anyone to handle its sales promotion work?

(Testimony of W. J. Cunningham.)

A. No, none at all. I handled that.

Q. Do you know what was paid in the trade at that time?

A. Well, I know of certain cases where five per cent was paid and some cases five per cent of the gross, some cases it might have been slightly less.

Q. Five per cent of the gross sales?

A. Five per cent of the gross sales paid, and some companies from time to time employed in some cases two or three salesmen.

Q. With respect to Mr. Morse, what, in your opinion, would the petitioner have had to pay for the services such as he rendered in 1942? [54]

A. I think he was justified in every dollar that he drew out of there. He worked very hard, the same as I did. We both worked exceedingly hard and spent long hours, 12 and 14 hours a day, seven days a week in many cases, night work and all that sort of thing.

Q. Did the petitioner employ guards?

A. No, that was an item—I believe that we were the only defense plant on this Pacific Coast that did not employ guards. We were able to convince the Army and the Army Air Corps that we were capable of handling our own guard situation. In most cases companies of this type and other types had to employ uniformed guards, on which the scale was a dollar an hour. We felt confident that our force would be able to police our little plant down there, and we would have had to employ about five guards at a dollar an hour, and it was considerable

(Testimony of W. J. Cunningham.)

saving to the management to do that ourselves. As a matter of fact, I swore in eight of my employees as special deputies to handle the guard work, and it was done very successfully, so successfully that we had no difficulty in any way, shape or form.

Q. Was that swearing in of the eight of your employees as special deputies with the knowledge or approval of any of the United States officials?

A. With the approval of the Army Air Force plant protection man, Henry Cady, and with the approval of the [55] Vernon Police Department, which these men had to be deputized through, and also were given a period of training by an Army officer there in the Navy Depot.

Q. Who fixed the business policies of the petitioner from March, 1940, through 1941?

A. The board of directors.

Q. Were meetings held throughout that period?

A. That is right, and every director was in attendance each and every time. In the business being started there were many problems we were confronted with from the standpoint of improvements to all buildings and buying different equipment and various and sundry things that had to be taken into consideration.

Q. During 1941 or 1940 did the directors receive any directors' fees?      A. No, sir.

Q. From 1941 did they receive any directors' fees?      A. No, sir.

Q. During 1942 how much was paid in directors' fees by the petitioner to its directors?

(Testimony of W. J. Cunningham.)

A. I believe there were ten stated meetings, in which we each received \$25.00 each, a total of a thousand dollars for the four directors.

Mr. Zeutzius: Will the counsel stipulate at this point that there was actually paid to the four directors [56] referred to and mentioned in Paragraph 21 of the stipulation of facts \$250.00 to each one of them during 1942?

Mr. McFarland: I will have no objection to your introducing the checks. I don't know what their pay as directors is, and I don't want to stipulate as a fact, if you have the checks there, as you claim, I have no objection to having them introduced in evidence.

Mr. Zeutzius: I wanted to keep down the size of the record, that was all my purpose in asking for the stipulation we have asked for, and that is that each of the four persons mentioned in Paragraph 21 were issued checks totalling \$250.00 to each, dating from August 31, 1942, through December 30, 1942, inclusive.

Mr. McFarland: That is correct. I have checked the checks.

The Court: Well, I should think it would not be necessary to introduce the checks in evidence. As I understand it, the witness has testified that there were ten directors' meetings and that each director was paid \$25.00, and that the total payments aggregated \$1,000.00 for the year 1942. It seems to me that that would be all that would be necessary, if there is no evidence to the contrary,

(Testimony of W. J. Cunningham.)

the court would find that that much was paid to the directors in 1942, without the introduction of the checks.

Mr. Zeutzius: In other words, your Honor thoroughly [57] understands that makes a total of \$250.00 each.

The Court: That is to each director, and the four would make an aggregate of \$1,000.

Mr. Zeutzius: And I wish to call your Honor's attention to the fact that it is ten meetings, and those are the only meetings during the year for which they were paid.

The Court: So I understand, and I don't think it will be necessary to introduce the checks as exhibits.

Mr. Zeutzius: All right, I will refrain from doing so, your Honor.

By Mr. Zeutzius:

Q. You were one of the directors who received \$250.00 for 1942? A. That is correct.

Q. What services were rendered by you for the amount that you received as a director's fee in 1942? What services were rendered as director for the \$25.00 that you received each time?

A. Attending meetings, spending several hours at meetings, more or less outlining the policies of the company, carrying out the wishes of the board of directors after we were authorized or told what to do. In other words, if we wanted to put any improvements in on our property it was authorized by the board of directors and I carried those [58]



(Testimony of W. J. Cunningham.)

wishes out, orders from the board of directors, as they would be. Does that answer your question?

Q. Were any services performed by the other directors, to your knowledge, for the \$25.00 fees which each received?

A. Well, those people all participated in the various stages in discussing improvements, they all took a very direct interest in everything, as a matter of fact they were all very keen about it, they wanted to see the business procedure under way so they took a very close interest in it.

Mr. Zeutzius: Now, I think the stipulation makes it clearly appear that the payment of the total amount of \$56,000.00, \$28,000.00 to Mr. Morse and \$28,000.00 to the witness, Mr. Cunningham, was actually made during the year 1942 by petitioner. That, I think, is the proper construction of our stipulation of facts, is that correct, counsel?

Mr. McFarland: I am sorry. I was not listening.

Mr. Zeutzius: In other words, may I ask, there is no doubt as to the actual payment of the \$56,000.00, one half of it to each of the two officers, Morse and Cunningham?

Mr. McFarland: That is right.

The Court: Very well. It will be understood that those amounts were actually paid to the two individuals.

Mr. Zeutzius: And were actually paid during the [59] taxable year.

By Mr. Zeutzius:

Q. For what did you receive \$28,000.00 in 1942

(Testimony of W. J. Cunningham.)

from petitioner?           A. Salary for services.

Q. For what did Mr. Morse receive \$28,000.00 during 1942?

A. Same thing, salary for services.

Mr. Zeutzius: I wish to direct the court's attention at this point that in the stipulation of facts it appears that in paragraph numbered 11 that the directors on January 5, 1942, adopted a resolution authorizing the payment of salary to Mr. Cunningham and Mr. Morse at the rate of \$24,000.00 for their services to each, and that that be effective as of January 1, 1942, and be paid in such installments, monthly or otherwise, as the officers might from time to time elect, and that the Exhibit 9-I of the stipulation reflects the drawings pursuant to that resolution and a subsequent resolution set forth in Paragraph 15 of the stipulation of facts wherein it was authorized by the petitioner's directors that the salaries of Mr. Cunningham and Mr. Morse be paid at the rate of \$36,000.00 for their services, and that that be effective as of September 1, 1942, and in such installments, monthly or otherwise, as the officers might from time to time elect, and that the resolutions were [60] carried into effect by withdrawals, as shown in Exhibit 9-I, and that exhibit as stipulated in Paragraph 23 being identical in all respects to the drawing account for Elmer D. Morse.

The Court: Very well.

Mr. Zeutzius: Now, barring some things I might have missed, that will conclude with the witness. I just would like to check.

(Testimony of W. J. Cunningham.)

The Court: We will recess for five minutes.

(A short recess was taken.)

The Court: You may proceed.

Mr. Zeutzius: There was one other thing I forgot to ask the witness.

The Court: Very well, Mr. Cunningham, please resume the stand.

By Mr. Zeutzius:

Q. With reference to the licensing agreements referred to in the stipulation, which were dated February 26, 1941, when and how were they obtained, very briefly?

A. Well, through my contacts with the aircraft companies endeavoring to secure business, I found they were using these processed alloys and that they were the only ones which the engineers would recognize as being suitable for aircraft construction, and I was informed at that time that if I could obtain one of those licensing agreements from [61] Alcoa, that they would consider doing business with me, so I immediately at that time started the necessary work to get them. I first contacted Bill Mellin, who was the manager of the local office of the Aluminum Company of America, and he informed me that ALCOA had not yet made up their minds as to whether or not they were going to give that licensing agreement.

Q. When was this, approximately?

A. This was about the latter part of 1939 or early part of 1940. Well, I persisted in the effort,

(Testimony of W. J. Cunningham.)

so much so that I asked Mr. Mellin if he objected to my calling him occasionally, and he said no he didn't object, and he then turned me over to a chap by the name of Joe Michaelson, and I asked him the same question, if he minded if I contacted him on certain occasions, which I proceeded to do on an average of three times a week, at 10:00 o'clock every morning I would call and say this is so and so, have you heard anything of the licensing agreement, and the usual answer was no, our Pittsburgh office hasn't made a definite decision yet as to whether or not they were going to grant any licensing agreements. Then the thought occurred to me that through my connections back East and through my wife's connections that possibly we could work the other end of it, so several letters were written to various relatives by my wife and friends of mine, and telephone calls made, and I [62] still persisted in it because I knew it was the answer to the business that I wanted to engage in, and finally after a series of long efforts and flying around and calls and various other things this licensing agreement was delivered to me at my home, that instructions were given Joe Michaelson to deliver it, that it was to be delivered to me personally and no one else, for which I was appreciative, and only after a long time and a lot of hard work we obtained it, and to be perfectly honest with you we had to have a foundry set up of a particular type or description before this license would be granted, and afterwards I became quite friendly with the Aluminum people,

(Testimony of W. J. Cunningham.)

particularly this man Joe Michaelson, who unfortunately is deceased now, but the man who took that job over told me the other day that he had made an investigation and that he saw no reason for not giving the licensing agreement to a company such as ours and he said that he was very happy to see the progress that had been made in utilizing this particular licensing agreement. That is about all I can say. It was a lot of hard work and there were many directions that we took to obtain it. Part of that matter is that other people were able to use it because of that experience, some one had done a lot of hard work in obtaining that particular agreement. It was only through the connections and friends that I had that I was able to obtain it. [63]

Q. Do you know where Mr. Elmer D. Morse is at this time?

A. Well, no. I tried to contact him myself last week and many occasions, and I even sent a man out to his summer home at Arrowhead to try to locate him, but I have not been successful. I have called his home, he is listed in the telephone book, but I have been unable to reach him. I tried many things to contact him since last week, to be here, and it is his duty to be here, frankly, I think.

Q. Is he any longer a stockholder?

A. No, he is no longer a stockholder in the corporation.

Q. Did the person you sent to Arrowhead make a report to you?

(Testimony of W. J. Cunningham.)

A. Not in writing, just a report to me that he was unable to reach him, that he was in the city, that is, in Los Angeles at his home.

Q. Is he a stockholder at the present time?

A. He is not.

Mr. McFarland: He said no.

Mr. Zeutzius: I am sorry. I wasn't sure whether I had asked him whether he any longer was or was not a stockholder. No further questions. You may cross-examine. [64]

#### Cross-Examination

By Mr. McFarland:

Q. Mr. Cunningham, you spoke of the availability to you of a scholarship at Colgate which came just before the last war, and which you could not take because of that. A. That is correct.

Q. By virtue of what efforts did you obtain that scholarship?

A. Well, I played professional football while I was a young fellow. Colgate was in the habit of awarding scholarships to men who were outstanding in that particular field. They had a mighty fine football team there, and I had played a little professional football when I was about that age.

Q. For your athletic ability?

A. For my athletic ability I was offered a free scholarship, that is true.

Q. Your training, of course, in grammar school and high school was general in nature?

A. That is correct.

(Testimony of W. J. Cunningham.)

Q. Was not pointed toward any specific object, was it?

A. No, it was not, not at that time, except business training which ultimately I wanted to go into.

Q. That was more or less general business training? [65]

A. That is right.

Q. Then you enlisted in the Armed Services?

A. I enlisted in the Cavalry to start with and later on changed to a machine gun battalion, and later on we were turned to a supply train.

Q. And at the end of the war you went to work for the Travelers Insurance Company?

A. Travelers Insurance Company.

Q. As a claims adjuster?

A. Claims adjuster, yes.

Q. What did you do in connection with that job?

A. Well, it was mostly nuisance claims, to be perfectly honest, being a very young chap without, you might say, any experience in the line, naturally I was given the minor claims to handle, like automobile losses and accidents.

Q. You adjusted personal liability and property damage claims in connection with automobile accidents?

A. Automobile accidents or losses, yes. I remember one time the claim of a lady who claimed she found a cockroach in her lemon pie and showed it to the manager of a restaurant, which they were our assured, and I had to make an investigation on that and a report on it, and things of that sort.

Q. And you stayed with them approximately one year?

(Testimony of W. J. Cunningham.)

A. Approximately a year, that is right. [66]

Q. Now, what was your salary, to the best of your recollection when you were working for them?

A. Oh, I would say offhand \$170.00 on top of my car expense and then the other expenses incidental to the job. As a matter of fact, I was only, to be perfectly honest with you, if you will check my age, I was about 19 years old then, a little over 19 years old, you will see when I was 20 years old, if you will check the years in between you will find out it will check out that way.

Q. How did it happen that you didn't go back and take up your schooling when you were discharged?

A. Well, because things were in rather a turmoil at the time, I didn't particularly care about it, and Army training had started me—changed my mind, perhaps, I don't know, I just didn't have any particular desire to go and finish that. At that time I wanted a business course, and frankly, my father had a very fine lumber business and I had always sort of looked forward to the time when I could engage in some type of business.

Q. Then you eventually went with your father in the lumber business?

A. In the lumber business, in the wholesale end of it, yes.

Q. I believe you testified that you started out as a salesman? [67]

A. Yes, and I was very successful, and one among other things, we bought five or ten million



(Testimony of W. J. Cunningham.)

feet of red pine crating lumber in Canada at a very low price, and as I remember we paid about \$9.00 a thousand, purchased it from, I believe, W. C. Edwards & Company, and as a matter of fact, the owner of the company is Sir Gordon Edwards, a member of Parliament, whom I know quite well. I was very successful that first year in marketing that to a trade that had never used that type of material before. I went out to find a market for it, and so much was sold, I sold ten million feet of lumber for them, and our commission in those days was \$2.00 a thousand, so you can figure out what I would have made if I had done it on a commission basis.

Q. It all went to the company?

A. It all went to the company, but I was paid a very reasonable amount for my services, though.

Q. About what were you paid?

A. Oh, I would say around—I don't know, 12 or 13 thousand dollars, something like that.

Q. That would be \$12,000.00 anyway?

A. During that year for services.

Q. Did you have any previous experience?

A. No, it was not necessary.

Q. You didn't have to be a specialist in this?

A. No, not on the selling of crating lumber to the [68] furniture people and things like that, that had never used that type of lumber before.

Q. Mr. Cunningham, I think you will agree, won't you that maybe you would not have had that favorable influence if it had not been for your father?

A. Yes, maybe so.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: I move to strike out the question and answer.

The Court: I will overrule the objection.

By Mr. McFarland:

Q. You were secretary and treasurer?

A. That is correct.

Q. During what period, roughly?

A. Oh, I think around from about three or four years after the new company was formed, the retail end of it, I went in as a vice-president of the company at the start.

Q. When was this?

A. I would say about 1923 or '24.

Q. You stated that the business, I think, went through a 77-B thereafter?

A. I stayed right there until the end of it, as a matter of fact so that I can account of at least 15 or 16 years of my time as spent on that.

Q. On this \$12,000.00 or \$15,000.00 salary that was recommended that you spoke of on direct examination—— [69]

A. Well, it wasn't all salary. It was commissions and it was other things.

Q. I was going to ask you that very thing. I want you to break down for me the amount of that total which represented salary and the amount which represented bonus.

A. Well, let's say half of it was bonus, the other half of it was commission and bonus. That is as near as I can arrive at it.

Q. Do you have any recollection other than just a general recollection?

(Testimony of W. J. Cunningham.)

A. No, a general recollection of it. There has been a lot of water over the dam since then, 26 years have elapsed, which is quite a long time. Can you recall back 26 years ago, what you did 26 years ago?

Q. I am asking you the questions.

A. I am telling you that, and that is why I must explain to you why I am telling it.

Q. I want you to be reasonably certain in your response.

A. I am reasonably certain. I would say about half salary and half commission and bonus, to the best of my recollection.

Q. And that is the relationship which prevailed throughout your connection with your father's lumber company?

A. Throughout my connection, yes, for many years. [70]

Q. In that connection, you came to know people such as Al Smith?           A. Intimately.

Q. And many political figures?

A. Yes, slept with Smith at the hotel in Albany.

Q. Was this before he wore that brown derby?

A. He has always worn the brown derby, and been a hell of a nice man.

Q. Did your business give you occasion to curry favor for this political business in New York State?

A. Yes.

Q. Of course, it was your position——

A. It was my position, the business I was in, I was selling lumber to the state departments right

(Testimony of W. J. Cunningham.)

along and selling lumber to various boards, state and county and so on. There are all using considerable materials at all times, and actually I was in active personal contact with a lot of people, and I like people and I made a wide acquaintanceship. As a matter of fact, I have built up a wide acquaintance here in California, for the years it has taken. You can make a check and you can ask dozens of people that can tell you without my telling you what I have been able to accomplish.

Q. That lumber company eventually hit upon financial straits? [71]

A. Due to the business conditions, yes.

Q. That was about when?

A. After the crash, say along about 1931 and 1932, yes.

Q. What particular element caused that particular lumber company to have some trouble?

A. That was just a complete stoppage of all business of every type and description. Industry slowed down, a lot of people were unemployed, no home building of any sort or description. I can recall an instance when for a period of about 30 to 90 days there was nothing built in that area.

Q. How large a company, how many salesmen did you have in this company? Were you a stockholder?

A. No, not at the first part of it. At the last I was.

Q. Just an employee?

A. Just an employee, that is correct.

(Testimony of W. J. Cunningham.)

Q. And subsequently a stockholder?

A. Subsequently a stockholder, yes. We employed one salesman at the time other than myself.

Q. And what was the gross sales that you would show?

A. About anywhere from three-quarters of a million to 850,000 or 950,000 a year, somewhere in that neighborhood.

Q. Now, so we can make a comparison, Mr. Cunningham, are you familiar, for instance, with the Edward Hines Lumber [72] Company?

A. I know Edward Hines quite well, a Chicago man, and he has got a little goatee. Do you happen to know him?

Q. I know him, yes.

A. He wears a little goatee.

Q. During that same period what would you say his gross sales were?

A. \$50,000,000.00 a year, maybe, I don't know, 25 million. They were a big company. They are now out of business, if you recall. They went through a receivership.

Q. You were a smaller business than the Edward Hines Lumber Company?

A. Oh, yes, there were dozens of lumber companies throughout the entire country. We only, I think, had 14 retail yards, and the total population of the environment amounted to about 305,000 people.

Q. This was Rochester, New York?

A. Rochester, New York, yes.

(Testimony of W. J. Cunningham.)

Q. After that the lumber company went through 77-B, I believe you said, in 1932 or '33?

A. Yes, about that date, as I can recall, it was somewhere in that period of time. It was reorganized and then continued for a while until the year 1935.

Q. And then you finally dissolved and went out of business? [73]

A. Finally dissolved it, paid all the bills of the corporation, leaving no debts whatsoever outstanding, and as a matter of fact, as I explained to you, I even had to hypothecate my insurance policies to pay them.

Q. In this reorganization under 77-B, what was the nature of that as far as the outstanding indebtedness of the corporation was concerned?

A. Well, I think we got—you mean, what did the corporation owe in money, is that the question you asked me?

Q. Yes, I want to know, were the creditors paid in full or did they suffer losses?

A. No, they received 75 cents on the dollar.

Q. And then you came out to the West Coast?

A. I came out to the West Coast in 1936, yes, in October.

Q. You say certainly up to this time that your experience had been wholly within the lumber company for which you were working at the time?

A. Oh, no, I wouldn't say that.

Q. You were employed and you were owner and director of the company?

(Testimony of W. J. Cunningham.)

A. Yes, but I wouldn't say that wholly. After all, a man does pick up knowledge of a great many things.

Q. I am not referring to that, Mr. Cunningham. I say [74] other than just the general knowledge that you picked up from being exposed to various other businesses, you did not have any particular training or you would not devote any time, for instance, to—I believe you referred to the Baldwin Locomotive Works; you didn't work for them at any time, did you? A. Oh, no.

Q. And the only problems you would be aware of that were Baldwin's problems would be when you came in contact with them in connection with your sales to the company?

A. Oh, yes, that is correct. I talked with their engineering department, the superintendent of their plant, perhaps, or something like that. I did very little work with the purchasing department except to get the purchase order from them. We generally worked with the practical men or the technical men in the companies to do what—

Q. When you came out here to the coast, you went to work for a lumber mill?

A. No, I went to work as a salesman, let's call it that, with one of the lumber companies here—well, it was the Globe Lumber Company, as a matter of fact, calling on the studios, calling on MGM and two or three of the studios and the industry, the same type of work, I was selling the house builder.

(Testimony of W. J. Cunningham.)

Q. Practically the same type of work you were doing [75] in Rochester?

A. That is right, yes.

Q. What was your salary with the Globe Lumber Company?

A. Approximately \$270.00 a month. They don't pay very good salaries on this coast. I paid bookkeepers higher wages than that in the East.

Q. Any commission?

A. No, I wanted a commission, but they don't allow commissions out here. They have kind of an understanding which amounts to a localized trust, in other words, each company has the same price, and unless you sell at that price you are more or less ostracized. That is perfectly true, might as well admit that is what happens. So consequently they see no reason for paying a man a commission basis. As a matter of fact, I met Mr. McLeod, who was an old friend that I first knew in Toronto, Canada, and he was one of the first contacts I made here. He remembered me after a while and we discussed things and he said, "Well, you would make an ideal manager for one of our retail setups." I said, "That's fine." He said "We might discuss the matter of compensation for it." He said, "What do you expect in the line of compensation?" So I set a figure that I thought would be rather low, at \$10,000.00 a year, and the man almost fell off the chair. He said, "Well, I don't [76] get that myself." I said, "I am very sorry." So we didn't get together. I said I was in the habit of paying a book-



(Testimony of W. J. Cunningham.)

keeper that amount to keep my books, \$500.00 a month.

Q. Now, you hit upon this foundry equipment during the course of your travels around Los Angeles?

A. That is right. I was desiring to get into business for myself, because I always had been. I was not interested in a job. A job didn't interest me in any sense of the word. I was looking for a business, a permanent business that I could get in.

Q. Who owned this foundry equipment?

A. Mr. Withers, Jane Withers' father, the little picture actress, you know.

Q. He turned that equipment over for some stock in the company that you formed?

A. Yes, and also made an investment along with it of \$500.00?

Q. You didn't put any money in?

A. I did not.

Q. Did you have any money at that time?

A. No, Mrs. Cunningham made the investment on borrowed capital.

Q. What did she put in?                   A. \$500.00.

Q. Mr. Withers had put in \$600.00? [77]

A. No, the equipment was \$600.00, I believe, and half of the money was \$500.00.

Q. You say your wife borrowed the \$500.00 to put in?

A. Yes, we were practically—I was living at that time on borrowed money.

Q. You didn't get that stock in your name?    ✓

(Testimony of W. J. Cunningham.)

A. I did not.

Q. Did your wife get some stock?

A. Yes, she had stock in the corporation.

Q. Now, I believe you spoke of having put up for the utilities, the deposits for the utilities?

A. That is right. That is customary in a new company when you don't have a credit rating.

Q. You put that up yourself?           A. Oh, yes.

Q. I mean you didn't pay that out of your own personal money?

A. Right out of my personal pocket, and then later on I was reimbursed. The books will show the deposits, yes.

Q. The company paid for them in time?

A. In time, yes.

Q. When did you first come into contact with the aircraft people?

A. Oh, let's see the latter part of 1940 or the middle of 1940, I can't just exactly tell you when, somewhere [78] in that neighborhood.

Q. And some time toward the latter part of 1939 or 1940 orders began to come in from the aircraft companies, didn't they?

A. No, we had no orders whatsoever.

Q. I am not talking about your company. I am talking about the expanding aircraft industry.

A. Well, no, I don't believe they came in as early as that, still they might. Visualizing the aircraft before the war, Douglas Aircraft was building——

A. I suppose you, being a capable business man,

(Testimony of W. J. Cunningham.)

recognized the advisability of working for the companies?

A. I frankly selected that as the business that I wanted to engage in. In other words, I had no idea that there was going to be a war; if I had, I could have been a millionaire many times over. I figured that as a business that I wanted to engage in. It was a highly technical business, it was an interesting business, because you were doing a different thing each and every day.

Q. When did you first come in contact with Mr. Withers?

A. That was in about 1939, I would say, somewhere around in there.

Q. What part of 1939?

A. The early part of 1939.

Q. When did you subsequently finally conclude the [79] deal whereby Withers turned this foundry equipment over to the company?

A. Oh, somewhere in 1940. I can't recall the exact dates.

Q. And of course Germany had gone into Poland at the time, hadn't it?

A. I don't recall. I think so, yes.

Q. She invaded Poland around September, 1939.

Mr. Zeutzius: Yes, I so stipulate.

The Witness: I think so. I don't know.

By Mr. McFarland:

Q. I believe if you check the records you will find it was roughly around that.

A. That is possibly true.

(Testimony of W. J. Cunningham.)

Q. But you still didn't have an idea of going into business on account of the war?

A. No, not altogether. If I had, I would have done an entirely different, I would have done a much bigger job and made considerably more success than I made of it.

Q. Then I gather there was a little bit of luck connected with it?

A. Yes, to a certain extent.

Q. But you say the war was not in any way included in your plans or determinative of your course of action?

A. How would any one man be able to figure, then, [80] that aircraft would win the war? I mean if I had that thought in mind, I naturally would have gone into another line of endeavor. There were other things to do other than just doing a lot of hard work and a back-breaking job building a foundry. There were many easier things to go into.

Q. This was one of them?

A. Have you ever been in a foundry? Do you know the type of work it is?

Q. I am generally familiar, yes.

A. If you know, then you grasp the idea what it is all about.

Q. This Aluminum Company licensing agreement, I think you said that was obtained in 1940 or around in that time?

A. That is correct, yes.

Q. What part did your wife play in that?

A. Well, Mrs. Cunningham had a cousin, as a

(Testimony of W. J. Cunningham.)

matter of fact, who was very close in with the Mellon interests living in Pittsburgh, had a place there and employed, I don't know, 30 or 40 salesmen, knew all the people there, and we correspond with him, always did correspond with him. His name was Ed Staedt. He is down East now.

Q. What was his business?

A. He had put in all the high-power installations in the New York Tube, and various and sundry things for Westinghouse. He was Westinghouse's agent there, and that [81] incidentally is a Mellon-owned concern, owned by the Aluminum Company of America, one of their subsidiary companies, and he was very influential with the company, he was one of the people I went to. Also a brother-in-law of Mrs. Cunningham's who was the general sales manager and vice-president of Rogers Shoe Company, and various other friends, among them was Henry Carlson, chief engineer of Gulf, along with half a dozen other people. It was only through them that I was ever able—I wasn't ever a foundry man, and the Aluminum Company just don't want to give away the stuff. After all, the Aluminum Company had some reason for it.

Q. Inasmuch as you were not a foundry man, as you say?

Mr. Zeutzius: I move to strike out counsel's statement.

The Witness: I wouldn't say I wasn't a foundry man.

(Testimony of W. J. Cunningham.)

By Mr. McFarland:

Q. Didn't you just say—what was your answer? I thought you said you were not a foundry man.

A. I meant that in the sense of not a man who has been in the foundry business many years. I had foundry experience previous to the licensing agreement.

Q. What foundry experience did you have?

A. Well, operating this particular foundry previous [82] to this licensing agreement, in which we made various brass pieces.

Q. When did you begin operating this foundry?

A. We started about 1940.

Q. What month of 1940?

A. I don't recall. April, perhaps.

Q. When did you obtain this licensing agreement?

A. I don't know. The licensing agreement was there. I am not going to go by hearsay on everything. I have to refresh my memory occasionally.

Q. Would you say you obtained it in February, 1941?

A. Is that in the licensing agreement?

Q. Yes, it is.

A. It was approximately that time, yes.

Q. This was the culmination of, I believe you stated—

A. The latter part of 1939 and '40 efforts, yes.

Q. Now, the latter part of 1939 and 1940, the company was not in existence in 1939, was it?

A. Well, yes, not active, you see, but contacts had been made.

(Testimony of W. J. Cunningham.)

Q. The company did not come into existence until April of 1940, is that right?

A. That is probably a fact.

Q. So the most that it could be the culmination of [83] would be from April, 1940, to February, 1941, is that correct?

Mr. Zeutzius: I move to strike out counsel's question as being argumentative, assumes a situation in asking the question and then assumes that it could not be. In other words, it is an unfair question.

The Court: I will sustain that objection.

By Mr. McFarland:

Q. Well, Mr. Cunningham, I believe you have stated that that company, Walts, Incorporated, was organized and started doing business in April of 1940?

A. I think the records show that, yes.

Q. Your licensing agreement bears date of February 26, 1941?

A. That is correct. I believe that is true.

Q. And that licensing agreement was obtained after some period, we will say, of work to obtain it on your part and on your wife's part?

A. That is correct, that is right, a very hard effort.

Q. Now, were there expenses incurred in that connection?

A. Yes, lots of expense. As a matter of fact, borrowed money was used in most cases to keep this thing going and to keep ourselves going, and

(Testimony of W. J. Cunningham.)

which we were not reimbursed in any way, shape or form for it. [84]

Q. Did you make any expenditures on behalf of the corporation?           A. Yes.

Q. Were you reimbursed for them?

A. No, never have been.

Q. Was your wife reimbursed?

A. No, never reimbursed for anything.

Q. You say she was never reimbursed for anything, excepting that licensing agreement?

A. That is correct.

Q. And now I direct your attention, Mr. Cunningham, to the minutes of the meeting of March 31, 1941, and in the body of the minutes, and I am quoting from the minutes—

A. Yes.

Q. —“Walter J. Cunningham advised the corporation had just obtained from the Aluminum Company of America, two written agreements licensing the corporation to use its heat-treating process for manufacturing aluminum alloys and products, and that the agreements were procured through the efforts of Catherine Cunningham, who incurred obligations and expenses in the sum of \$1140.00 in obtaining these agreements.” Is that right?

A. If the record so states, it is probably true, yes.

Q. Would you say this was not true?

A. No, I say that the record which you have in that [85] book is evidently true, that we wouldn't



(Testimony of W. J. Cunningham.)

have that in there unless it was true. What would be the reason for it?

Q. I am not arguing with you.

A. Let's not argue about the point.

Q. I am merely asking you a question.

A. And I am answering them.

Q. And so what you said previously is not borne out by these minutes, is it?

A. Perhaps not. I don't know. It has been a long time.

Q. As a matter of fact, in the rest of the minutes it is resolved and it provides, authorizes and directs the payment immediately of \$1140.00 to Catherine S. Cunningham to reimburse her for the monies expended for and on behalf of this corporation, and the president and secretary-treasurer are hereby directed to draw upon the funds of this corporation in accordance therewith, isn't that right?

A. If it states that in there, it is probably correct, yes.

Q. That is correct, to the best of your knowledge?

A. To the best of my knowledge, yes.

Q. And your previous testimony is not correct in that behalf?

A. Possibly not, not in every respect, and I am not to blame for that because it is quite a long time and I [86] don't recall all the incidents in connection with it.

Q. Do you recall the incident in connection with obtaining the foundry equipment?

A. Yes, certainly.

(Testimony of W. J. Cunningham.)

Q. And you were able to remember the number of square feet in the building on Boyle Avenue, is that right?      A. Yes.

Q. But you don't recall other details that happened about that same time?

A. Oh, no, I recall practically everything.

Q. But you didn't recall this fact?

A. Well, you have to refresh your memory, you know. I can't just recall that transaction, no.

Q. Who had physical possession of these minutes?

A. I did, secretary-treasurer of the company.

Q. They were always available to you?

A. They were always available to me and always kept in our office safe, never out of our possession.

Q. Do you know any of the elements entering into any of this \$1140.00 that were reimbursed to your wife?

A. No, I frankly don't recall it. It is a transaction that happened some time ago, and I would have to refresh my memory. I don't just recall just what it is.

Q. After you had obtained the licensing agreement, in 1942 the Aluminum Company made that aluminum process [87] available to all in the field, isn't that right?

A. No, they did not.

Q. What did they do?

A. When, at the time we received it?

Q. No, no. Did you receive a letter from the Aluminum Company of America dated August 20, 1942, to Walts, Incorporated?

(Testimony of W. J. Cunningham.)

A. That letter I don't remember if I read the letter. I couldn't tell you whether I received that or not. I can't recall. No, you are asking me something. If you are right, I say I don't know.

Q. Have you not read this stipulation?

A. I sure have, yes, and I recall letters and other things, but I have to refresh my memory to find out whether you are right to be sure.

Q. I will gladly show it to you.

A. That is what I want to see. After all, I am not a memory expert on everything.

Q. I thought that maybe you were.

A. No, I am not. Yes, I recall this letter, quite well. That is correct. Yes.

Q. What is the sum and substance and the effect of that letter?

A. Well, all royalties were off for the duration of the war until the war was declared officially over.

Q. And the process was available to all who cared to avail themselves of it?

A. That is correct, yes. It was a government directive that where it was for war emergency uses it was available to anyone who cared to use it after that time.

Q. You were busy with war work at about that time, weren't you?           A. Yes, we were.

Q. Were all of your customers war aircraft companies at that time?           A. At that time, yes.

Q. Did you ever have an appreciable amount of non-war work?

A. Yes, some. You were not permitted to make anything but for the war effort of these particular

(Testimony of W. J. Cunningham.)

alloys, you couldn't use them in any other purpose other than it is intended for.

Q. When you obtained this agreement in 1941—

A. It was just for that one purpose, for the manufacture of aircraft parts solely for stress materials, for use where the heat-treating process had to be applied.

Q. And those parts and equipment for airplanes were on short supply at all times, weren't they?

A. Those parts were in very short supply at all times, yes. [89]

Q. At that time, around about that time, when the industry was expanding greatly?

A. I wouldn't say that exactly, no.

Q. In other words, what was the occasion that would give rise to the Aluminum Company issuing such a letter?

A. Well, I think most, more or less from the fact that a lot of pressure was brought on by the government to the effect that that was a closely held deal that they had to let out some of those licensing agreements to get away from monopoly, let us say, more or less, which they did have.

Q. They didn't have anything to do with the war effort?      A. No, I wouldn't say that.

Q. You wouldn't say that?      A. No.

Q. Now, Mr. E. D. Morse, are those his initials?

A. Yes, Elmer D.

Q. He came into that business, into the company, at one time or another, didn't he? About what period of time did he enter?

A. Oh, I think it was about around March, I think, of 1941, as I recall it.

(Testimony of W. J. Cunningham.)

Q. When he entered the business he also loaned the company some \$8,500.00?

A. His wife loaned the company \$8,500.00, Dorothy M. [90] Morse.

Q. What was that for? A. A loan.

Q. For what purpose was it made?

A. To buy equipment, setting the foundry up for the purpose of using these various alloys.

Q. At that time the company did not have available \$8,500.00? A. Sufficient funds, no.

Q. To purchase this equipment on its own, it required additional capital? A. That is right.

Q. That is the reason Mr. Morse entered the business?

A. No, he came in there for the purpose of assisting me in the work that we knew would eventually become too heavy for me to handle.

Q. Prior to that time what had Mr. Morse done?

A. Well, as I remember he had owned several sporting goods stores. As a matter of fact, I believe he had three of them at that time. I think he had a series of sporting goods stores in there. He is a man that had quite a bit of financial and other experience.

Q. He had about the same knowledge of affairs as compared to yours for his end of the business, is that right? [91]

A. Yes, I had know of him and had dealings with him, and they used a considerable amount of cash to put this transaction through. He was not called in for that sole object.

(Testimony of W. J. Cunningham.)

Q. When was Mr. Morse's connection with the company terminated?

A. I believe about June of 1943.

Q. In other words, his usefulness had ended at that time?

A. No. I wouldn't say that, no.

Q. All right, what was the occasion for that, if that was not the reason why he left?

A. We are talking about 1942, I believe, and not 1943, if you don't mind.

Mr. Zeutzius: I submit, your Honor—

Mr. McFarland: I am asking the question and I would like an answer.

The Witness: I am not answering it because I—

Mr. Zeutzius: I would like to suggest to the Court that 1943 is not involved. I don't want to object to anything that may have a bearing on the case, but I think it clearly appears that Mr. Morse is no longer with the company, the witness has stated that he ceased being there in 1943, and I think any further questions are not material.

The Court: What is the object, Mr. McFarland?

Mr. McFarland: I would like to determine under what circumstances Mr. Morse left there, whether it was due to one cause or another. I think it is very material to the Court in determining what is a reasonably fair compensation for Mr. Morse. As a matter of fact, if the Court please, neither is the year 1940 involved in the proceeding, which counsel has been so zealous in getting before the Court. I don't see that I should be limited because the particular year is not now involved, when the connection

(Testimony of W. J. Cunningham.)

of the severance of the connection of this individual who was an officer of the corporation occurred in that year, for some reason which might be a reflection on the past services and have a material bearing.

Mr. Zeutzius: I submit, your Honor, that in the year subsequent to 1942 many things can happen, a man may have a breakdown in health from overwork.

Mr. McFarland: Well, if that is the situation, let it be brought out.

Mr. Zeutzius: He might have family difficulties. I am not suggesting that is the fact, I am giving it to apply abstractly to any person in the company, any number of things might happen. I think it has absolutely no bearing. The question is whether or not the man performed certain services during the taxable period, what he actually did and what his abilities were then, not what they might [93] have been thereafter.

The Court: I don't see, unless you can relate some incidents that you expect to prove as to him, I can't see where it would be relevant as to why he terminated his connection with the company in 1943, which is the year following the taxable year. What do you expect to show that would be material in that respect?

Mr. McFarland: If your Honor please, I have no idea what the proof would show on this.

The Court: Well, I will sustain the objection, then. The relevant year is 1942, and what services Morse performed, what he was paid for it and things of that kind, in 1942.

(Testimony of W. J. Cunningham.)

Mr. McFarland: Will reference to the year 1940 be treated in the same fashion?

The Court: Well, except for the background and experience and so on. We like to be pretty lenient about that, you know.

Mr. McFarland: I see.

By Mr. McFarland:

Q. The sales of the company increased greatly, didn't they, throughout 1941 and throughout 1942?

A. Throughout 1941, I believe that the volume of approximately of 9,000 in 1941 to 128,000 in 1941, I don't recall the figures offhand. [94]

Q. I believe your records show that your sales increased, that in August of 1931—

Mr. Zeutzus: 1941.

By Mr. McFarland:

Q. 1941, I stand corrected, your sales were in the amount of approximately \$7,200.00, and by the end of the year they had increased to \$39,000.00?

Mr. Zeutzus: For the whole year, counsel.

By Mr. McFarland:

Q. That is cumulative for that year?

A. That is right.

Q. And the sales by months ranged from \$7,200.00 on August 31st to about \$13,000.00 on December 31, 1941?

A. Yes, probably the records show that.

Q. And in 1942 they raised spectacularly, didn't they? A. I don't recall the monthly figures.

Q. What was your gross sales volume?

A. Approximately \$470,000.00, I would say, off-hand, for 1942.



(Testimony of W. J. Cunningham.)

Q. What proportion of that was due to your sales to the aircraft companies?

A. What proportion of that was sales to the aircraft companies?

Q. Yes. [95]                   A. All of it.

Q. All of it?                   A. Yes, sure.

Q. You didn't have any business with any other industry?

A. You couldn't do business with any other industry, the war effort would not permit you to do it. You could not sell commercial aluminum to anyone throughout the war period. You had to ask the military authorities for permission. Anyone who did that, if I did it, I would have been in jail. You couldn't get any aluminum, all that you purchased had to be used for building aircraft. You had to bring in your purchase orders and specify how much aluminum you needed for the work and schedule your raw materials before you could receive it. So there was absolutely no way of getting any other material in. You were issued just your requirements for your aircraft companies. There was no other way of doing it.

Q. Mr. Cunningham, the company at no time paid dividends?                   A. Never.

Q. And never even discussed the feasibility?

A. Well, we talked about the feasibility of paying dividends.

Q. When did you talk about that? [96]

A. I don't know. In 1942 we discussed it.

Q. Who discussed it?

A. The directors of the company and officers.

Q. In directors' meetings?

(Testimony of W. J. Cunningham.)

A. Sure, we discussed it in informal discussion, never entered on the record.

Q. Never got in the records at all?

A. No.

Q. And the company never did pay dividends at any time? A. No.

Mr. Zeutzius: Now, I submit, I move to strike out the question and answer. I think it should be limited to any time between the incorporation and the end of the current taxable year involved, because that involves—

The Court: I deny the motion to strike, and the answer can stand.

Mr. Zeutzius: In taking the exception, I would like to call your Honor's attention to this, if the evidence is permitted to go beyond the taxable year, it involves or may involve unfair inferences unless we be permitted to show all the facts that occurred subsequent to the taxable year.

The Court: We will just confine it to 1942. No dividends were paid in 1942.

Mr. Zeutzius: Thank you, your Honor. [97]

The Court: The rest will be stricken.

Mr. McFarland: Do you care to amend the stipulation of facts, counsel?

Mr. Zeutzius: No, I am satisfied that the stipulation of facts will show it is perfectly true that from the time they were incorporated in 1940 through 1942 no dividends were paid. Is that what you want?

Mr. McFarland: That is shown, I believe, by the stipulation of facts.

The Court: The stipulation still stands.

Mr. Zeutzius: I think it is a fair stipulation.

(Testimony of W. J. Cunningham.)

Mr. McFarland: I just don't understand what—

The Court: What he is objecting to is any testimony that no dividends were paid subsequent to 1942, as I understand it.

Mr. Zeutzius: That is correct.

The Court: I will sustain that.

Mr. McFarland: Very well.

By Mr. McFarland:

Q. Mr. Cunningham, at no time—am I right when I make this statement—did you ever contribute financially to the company?      A. Never.

Q. Never?      A. No. [98]

Q. You have never been a stockholder for that matter, have you?

A. Not during that period, no.

Q. Subsequently you did own some stock, is that right?

A. I am referring to 1942. I was not a stockholder in 1942.

Q. Were you a stockholder in 1941?

A. No.

Q. Were you a stockholder in 1940?

A. No.

Mr. Zeutzius: The answer is not as to all three years.

The Witness: That is correct.

By Mr. McFarland:

Q. At all times the corporation obtained credit elsewhere than by your individual resources?

A. Yes.

Q. Now, tell me what yardstick did the corporation use to determine the amount of salaries that it was going to pay to you and to Mr. Morse? And I

(Testimony of W. J. Cunningham.)

am referring specifically to the minutes of January 5, 1941, wherein it is stated that notwithstanding any action heretofore taken by the board of directors by resolutions or otherwise, the president, Walter J. Cunningham, is to be paid at the rate [99] of \$24,000.00 a year for his services and the secretary-treasurer, E. D. Morse, is to be paid at the rate of \$24,000.00 for his services? How did you determine 24,000? Why not 23 or 25?

A. The reason, for past experience and performances I believe that was, they said I was just entitled to that amount of money.

Q. Well, past experience and performances, what do you mean by that?

A. Well, previous years that we were in the company.

Q. Previous to January 5, 1942, is the basis of this action? A. I wouldn't say that, no.

Q. Well, the meeting was held January 5, 1942.

A. Yes.

Q. Now, you certainly were not taking into consideration what might occur subsequent to January 5, 1942? A. No.

Q. You were not considering that at all?

A. No, we just took it as compared to other industries or other people in the same line of business.

Q. You were not considering what would occur subsequent to January 5, 1942?

Mr. Zeutzius: Are you asking the witness what he considered or are you asking him to speak for the other [100] directors as well?

Mr. McFarland: I am asking what he considered.

(Testimony of W. J. Cunningham.)

If he can speak for the other directors, I am very glad to have that.

The Witness: No, I can't speak for the other directors. I speak merely for myself. I don't know. It is rather difficult for me to answer.

By Mr. McFarland:

Q. You could not answer that? A. No.

Q. I believe you said that your gross sales in 1941 were approximately \$30,996.19?

A. Well, we have the record there. I can verify it by—

Q. On that basis you still earned \$24,000.00, for both you and Mr. Morse?

A. Well, I don't know, perhaps we took into consideration previous work that had been done in forming the corporation, and then we might have considered that we received no compensation for those years of working at it, we might have taken that into consideration.

Q. And I believe at that time the surplus of the company, the earned surplus of the company amounted to \$38.46? A. At which time? [101]

Q. On December 31, 1941, just five days before January 5, 1942, amounted to \$38.46.

A. Possibly.

Q. And the next year the company added to earned surplus approximately \$9,000.00?

A. Yes, that is true, probably. The figures are all there.

Q. Now, I direct your attention to August 28, 1942, and I read a portion of the minutes of that directors' meeting. It says, "Resolved, that notwithstanding any action heretofore taken by the board

(Testimony of W. J. Cunningham.)

of directors, by resolution or otherwise, that President Walter J. Cunningham be paid at the rate of \$36,000.00 per year for his services and that Secretary and Treasurer E. D. Morse be paid at the rate of \$36,000.00 per year for his services." You recollect that meeting, don't you?

A. Yes, I recall that very well.

Q. Now, your sales from January, 1942, to August of 1942 increased from \$11,000 to \$170,000. That is what the records show? A. Yes.

Q. Did that have any bearing or not?

A. Possibly so, yes. You are entitled to additional compensation, I believe, I mean under the laws of the land.

Q. I am not arguing. I am just asking you and [102] attempting to find out the facts, Mr. Cunningham. I was not present at this meeting.

A. I understand you were not present, yes.

Q. I don't know what transpired in that meeting.

A. Oh, yes, the minutes show what transpired. This is your minute, isn't it? This is the record of that meeting right in there.

Q. And that is the only considerations that were involved, insofar as you were concerned?

A. As far as I am concerned, yes.

Mr. McFarland: If the Court please, I don't know whether you care to have me offer now or later these minutes. I would like to introduce as exhibits in evidence three minutes, March 31, 1941, January 5, 1942, and August 28, 1942.

The Court: I think you might as well do it at this point, Mr. McFarland.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: May I say this: I loaned counsel this minute book. We don't want it out of our possession, except for the purpose of photostating.

The Court: Yes, you may substitute photostats.

Mr. McFarland: Yes, we will substitute photostats.

Mr. Zeutzius: In other words, I don't want it to get out, sir. [103]

Mr. McFarland: We will offer them and make photostats and substitute the photostats.

The Witness: That is right, we don't want to lose our minute book.

The Court: Counsel will make photostats from the minutes that are offered and then return it to you.

Mr. Zeutzius: Fine.

The Court: Will you identify them one by one, Mr. McFarland?

Mr. McFarland: I offer as Respondent's Exhibit L minutes of the special meeting of the board of directors of petitioner held on March 31, 1941.

The Court: That will be received as Respondent's Exhibit L.

(The minutes referred to were marked and received in evidence as Respondent's Exhibit L.)

Mr. McFarland: And I offer as Respondent's Exhibit M the minutes of the meeting of the board of directors of Walts, Incorporated, held on January 5, 1942.

The Court: That will be received as Respondent's Exhibit M.

(Testimony of W. J. Cunningham.)

(The minutes referred to were marked and received in evidence as Respondent's Exhibit M.)

Mr. McFarland: I offer as Respondent's Exhibit N the minutes of the meeting of the board of directors of [104] petitioner held on August 28, 1942.

The Court: That will be received as Respondent's Exhibit N.

(The minutes referred to were marked and received in evidence as Respondent's Exhibit N.)

Mr. McFarland: And respondent at this time asks to substitute photostats for the originals.

Mr. Zeutzius: May I ask the object of offering these particular minutes? Because that puts the petitioner in this position, that I must request the Court to give consideration to practically every statement that is contained in that, so it puts us in the position of having to offer all the minutes.

The Court: Well, I think that inasmuch as the question of salaries is involved that it would be relevant to show that authorization. I don't know what additional evidence you will put in, but it seems to me that those particular minutes would be relevant evidence. You may inquire about that, of course, and introduce any circumstances in connection with them and so on.

Mr. McFarland: I have no objection if the petitioner so desires, to putting the whole minute book in.

The Court: Well, the Court would not want to wade through the whole book of the corporation.

Mr. McFarland: That is the reason I eliminated



(Testimony of W. J. Cunningham.)

the rest of them, the rest of the bulky records which have no particular bearing on the subject-matter of the controversy.

Mr. Zeutzius: For instance, the minutes of August 14 have not been offered. They include a resolution authorizing the payment of directors' fees.

The Court: Well, you can put them in.

Mr. McFarland: Surely, he can put them in.

Mr. Zeutzius: I might make my offer, if the Court please.

The Court: Yes, unless you want to offer them later on.

Mr. Zeutzius: Very well.

By Mr. McFarland:

Q. Now, Mr. Cunningham, have you ever heard of the Emergency Price Act of 1942?           A. Yes.

Q. Do you recall when that became effective?

A. No, I don't.

Q. What did that Price Act bear upon?

A. I don't know, you will have to give me that.

Mr. Zeutzius: I submit—

The Witness: We are going into something here now that you— [106]

The Court: If you don't know, you just say you don't know and that is all there is to it.

Mr. Zeutzius: I submit the question is one which should be asked of an attorney.

The Court: Well, he said he didn't know.

Mr. McFarland: He has answered he doesn't know. May I have just a minute, if the Court please, to go over my notes? I believe that is all of this witness.

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: First of all, the petitioner offers the minutes of August 14, 1942.

The Court: The petitioner offers in evidence the minutes of August 14, 1942. It will be received as Petitioner's Exhibit No. 11, and permission is granted to substitute a photostat copy.

(The minutes referred to were marked and received in evidence as Petitioner's Exhibit No. 11.)

Mr. Zeutzius: During the lunch hour I shall try to go through and see if there are other exhibits.

The Court: You may.

#### Redirect Examination

By Mr. Zeutzius:

Q. Mr. Cunningham, did you ever use your automobile in the company's business?

A. Yes, on all occasions.

Q. Did you always receive reimbursement? [107]

A. No.

Q. On that cross-examination you were asked concerning whether you ever put any money into the company for which you were not reimbursed or in substance to that effect.

A. Yes, well—

Q. Is that a correct answer, that you did not?

Mr. McFarland: Let's not ask him to answer, if the Court please. He could not answer. I don't know what the exact wording of the answer was, and I submit at this point it is not a proper question. I object to it.

The Court: Well, I will overrule the objection.

By Mr. Zeutzius:

Q. Do you recall—did you mean by your answer—Just what did you mean by your answer?

(Testimony of W. J. Cunningham.)

A. Well, I don't know. I did spend sums of money from time to time which I never kept a record of, for the helping of the corporation, yes, but I never kept records of it. I mean, I could not verify it in any way, shape or form, if that is the answer you want. I don't know those dates. I can't tell you of it. I mean a person does everything he possibly can to get going, he doesn't think so much of those things.

Q. You were asked concerning your knowledge of the foundry business on cross-examination. When the petitioner started, did you employ experts in the foundry business? [108]

A. I did not.

Q. Were experts, were skilled workmen of any sort employed?

A. They were not available. They had to be trained. Each man had to be trained separately for his job.

Q. What are some of the workers' jobs which require skill in connection with the foundry business that was operated during 1942 by petitioner?

A. Well, grinders, for instance, is an item for which the men had to be trained separately for it. We have what we call a casting line. On a casting you have to grind your casting completely on a tolerance. The aircraft companies will not use it if there is not enough so-called meat on it to machine off, but each casting had a different line, there wasn't one casting that looked alike, they were all different, so far as sizes, some have curves in, others don't have curves in.

Q. What were some of the others in addition to the individuals you have mentioned?

(Testimony of W. J. Cunningham.)

A. Grinders?

Q. Grinders.

A. All right, we have molders. Molders were available out of the iron industry. I don't think on this whole Pacific Coast there were 50 men who were experienced molders in the aluminum work. We had to bring molders in from the [109] iron shops.

Q. Were they trained?

A. They were trained in certain respects to make a mold, yes, with your risers and gates which are similar to the ordinary type of iron mold, but we had to do a good many experiments with those to find out just where your gate should be, you had to know your metal, and we had to coach them and train them in the business, in that field.

Q. Did anyone in the petitioner's plant train all these workmen to perform their jobs?

A. Well, we worked together. I mean, they probably assisted one another and got trained along with what they taught. I can't explain it any different.

Q. Were there persons known as core makers?

A. Oh, yes.

Q. Who trained them?

A. Well, core makers were in a little different category. There were ones that you could train and there were core makers that had been in that line of industry only with iron. Core makers were plentiful. It is not as difficult a job as a molder. There is nothing difficult about it.

Q. Take your patterns.

A. Pattern equipment had to be made and produced and gates put on properly so that your castings would result properly. We had to get a great

(Testimony of W. J. Cunningham.)

deal of information in [110] connection with that.

Q. Who took charge of that? A. I did.

Q. How many employees did you have during 1942, roughly?

A. Oh, I would say roughly 55 to 65, off and on. There were generally 10 to 15 per cent changing around. They came in one day and they quit the next.

Mr. Zeutzius: On direct examination I asked him to detail some of the different duties he performed. I forgot to ask him what the company would have had to pay for a job in there called metallurgist. I would like to revert back now to direct examination for just a couple of questions.

The Witness: Let's put it this way, that we had very few salaried people working for the company, and most of them took care of a number of duties in the early days. Let's say we take the job of a shipping clerk, at \$1.15 to \$1.20 an hour and that required certain duties, and in those days I handled that at all times and spent from two to four hours a day, because we had to make that shipping division of the corporation's business work, and we not only had to get out the castings but they had to be shipped and sent to the different companies. I did everything to secure and hold business. The airplane companies insisted that each [111] lot of metal poured be handled separately and a sample made for testing and the castings would have to correspond to the sample, and we had to keep track of the heat in the furnace that was carried through, had to report to the aircraft companies any differences in the process, and everything had to correspond.

(Testimony of W. J. Cunningham.)

Q. Who performed those duties in the shop along in 1942?       A. I did most of them.

Q. You stated, I believe, on direct that you did metallurgy as well?

A. I had some very fine books on metallurgy that I obtained, and these men came around to check up, I gathered all the knowledge that I could from studying and asking questions of the men. Of course, naturally, that I did on my own.

Q. When did you do this studying?

A. Right at the early period, shortly after we received the licensing agreement.

Q. Did petitioner employ a metallurgist?

A. No, we did not.

Q. What would petitioner have had to pay a metallurgist for the duties that you performed in 1942?

A. Well, let's take the Aluminum Company, for instance, who were so notorious for low pay. They paid one [112] man about \$55.00 a week, Lee Payne. He is available, we can call him and I think Lee Payne will tell you that is about what he is making now. He has been with the company about 15 years at least. It is very low pay there.

Q. Who occupied the position of invoice clerk?

A. Well, sir, I did temporarily at the start, but it was rather a difficult thing, because everyone around there worked in on those things, and I was practically the only one at the start of the business who understood the handling of all that detail.

Mr. Zeutzius: I am not sure that I recall the exact state of the record with respect to the amount of taxes Mr. Cunningham paid for 1942. I don't know whether the record shows what the amount was, or whether it was ruled out. Do you recall?

(Testimony of W. J. Cunningham.)

The Court: You stated that if the testimony was admitted, it would show that on his individual income tax return he returned these amounts for the taxable year on his income tax return. I sustained the objection, as I did not consider that as relevant, and you excepted to it.

Mr. Zeutzius: May I in addition to taking an exception make an offer of proof?

The Court: You may if you want to.

Mr. Zeutzius: That proof would show that Mr. Cunningham and his wife filed separate returns on an [113] individual property basis, that a total compensation was reported of salary of \$28,000.00 and the directors' fees and an auto allowance, which aggregated \$29,015.00, \$29,615.50.

The Court: Gross income.

Mr. Zeutzius: Gross income, yes. The director's fee was also set at \$500.00, so that the gross income would be \$29,015.50, and that total taxes were paid thereon of \$3,866.88.

The Court: Very well, it will be noted in the record that petitioner offers these amounts paid by Mr. and Mrs. Cunningham, which you object to.

Mr. McFarland: I object, if the Court please.

The Court: And the Court sustains that objection because the Court considers that not relevant and not material, to which the petitioner excepts.

Mr. Zeutzius: Thank you, your Honor.

The Court: Well, have you about concluded?

Mr. Zeutzius: Just about one more matter.

By Mr. Zeutzius:

Q. With respect to the amounts which are referred to in the two resolutions fixing the salaries of

(Testimony of W. J. Cunningham.)

yourself and Mr. Morse, was it your opinion at the time of the passage of those resolutions that the amounts fixed were fair and reasonable for the services performed by either of you during 1942? [114]

Mr. McFarland: I object, if the Court please, to that question.

The Court: I will overrule the objection.

The Witness: We did not consider those salaries any too high, in view of what we had done in past times, and everything else, we did not consider the salaries as set too high a figure. We thought that was a normal procedure.

By Mr. Zeutzius:

Q. Did you consider them fair and reasonable?

A. Fair and reasonable.

Mr. McFarland: Object to leading questions, if the Court please.

Mr. Zeutzius: That was a direct question and trying to get a direct answer.

The Court: I think that, of course, in the final analysis is what the Court has to decide, but I have always ruled in these cases where salaries were fixed that they have a right to give their opinion as to whether they were reasonable or not, and he has given his opinion.

By Mr. Zeutzius:

Q. Can you recall whether the other directors by their discussions at the two meetings at which the salaries were fixed during 1942 stated, or in substance stated, whether or not they considered the salaries as fixed as fair and reasonable? [115]

A. We did, yes, in view of the fact of all the hard work that we had done during the past, and



(Testimony of W. J. Cunningham.)

of course if they had not considered them fair and reasonable compensation they would not have voted for them.

Q. Did you or did you not intend at the time of the passing of those resolutions to cause the salaries ordered and authorized to be in the nature of a withdrawal of profits in lieu of dividends declared?

Mr. McFarland: That question I object to, if the Court please, on the ground it is clearly leading, and secondly, it is another element of fact that the Court is called upon to decide.

The Court: I think a better question would be, if the one part of his objection is sustained, which is that it is a leading question, I think a better question would be, did the directors have any other purpose in mind when they directed that these salaries be paid than to pay compensation for the services.

Mr. Zeutzius: I would like to adopt the Court's question. Will you answer that question? Do you understand the question?

The Witness: Well, no, I don't quite get it, frankly. There is no such question. I don't know what you're driving at, I mean the question was so complicated. I mean, I am a layman, I am not an attorney. [116]

The Court: Well, let me put the question. The point is simply this: The Commissioner's contention is that the salaries were made higher in order that a dividend distribution be made to the corporation, in reduction of the dividend distributed. Now, the question is, when you authorized these two salaries, as I understand of \$28,000.00 to you and \$28,000.00

(Testimony of W. J. Cunningham.)

to Mr. Morse and then in August you authorized \$36,000.00 to you and \$36,000.00 to Mr. Morse, when you authorized them, did you have in mind anything else except the authorizing of compensation?

The Witness: No, I don't think so.

Mr. McFarland: That answers it.

The Court: We will recess now until 2:00 o'clock.

(Whereupon, at 12:45 p.m., a recess was taken until 2:00 p.m. of the same day.) [117]

Afternoon Session—2:00 p.m.

The Court: You may proceed.

Mr. Zeutzius: May it please the Court, I have two witnesses who are rather busy individuals, and with the Court's permission and counsel's permission, I would like to put them on out of order at this time.

Mr. McFarland: No objection. I have just a few questions of Mr. Cunningham. If counsel cares to take them out of order—is that what you wanted to do?

Mr. Zeutzius: Yes.

Mr. McFarland: I have no objection.

Mr. Zeutzius: Will you call Mr. White? Mr. White, will you take the stand?

ERNEST S. WHITE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Ernest S. White?

A. Right.

(Testimony of Ernest S. White.)

Q. Will you state your age? A. 43.

Mr. McFarland: If the Court please, Mr. White was in the court room this morning, and I move that he be [118] disqualified on the ground of the prior motion excluding the witnesses from the court room.

By Mr. Zeutzius:

Q. Were you in the court room this morning, Mr. White? A. Yes, I was.

Q. For how long?

A. Oh, I would say for about possibly 40 minutes.

Q. A little before noon adjournment?

A. Yes.

Mr. Zeutzius: I didn't know the witness was in the court room, but of course there is that ruling, though, your Honor, and—

The Court: What is the purpose? What do you except him to testify to?

Mr. Zeutzius: Just to show that he is a foundry man and is familiar with what is paid for certain jobs during the period in question, some of the types of jobs that were performed by Mr. Cunningham. However, I submit the matter to your Honor for your Honor's ruling. I didn't know the witness was in the room, and had no reason—

The Court: He is not going to testify to any point of information about the petitioner's business, is he?

Mr. Zeutzius: Well, he was familiar with the petitioner's business at the time. He represented others [119] who dealt with the petitioner, had dealings with the petitioner.

(Testimony of Ernest S. White.)

The Court: Well, inasmuch as we have the rule, I am afraid we will have to sustain the objection.

Mr. Zeutzius: Well, I make an offer of proof, that by this witness we would expect to show that a production man, we understand, in another foundry here in town during approximately the same period as is involved got a thousand dollars a month for merely handling the production work, and in another instance a man was paid \$1,500.00 a month by the same concern for just the superintendent of the foundry part of the plant, sort of a foreman, and another individual was paid as a salesman for the same company \$8,000.00 a month, less expenses, just for selling. We would expect to show that another individual who was just the office manager received in a plant of comparable size \$24,000.00 a year at about the time in question; another man in a competitive institution as a foundry superintendent received \$18,500 a year as a part owner, and he was just the foundry superintendent, and we would also show that this witness received up to ten per cent on net sales as his compensation during the last several years in the foundry business on sales made by him. We would show that he is familiar with the foundry business, and he acted as a salesman or on the production sales end; that in the trade it was common to pay, [120] among other things, five per cent of gross sales made by a man. We think that that evidence would especially tend to justify in its entirety what occurred in the evidence so far in behalf of the petitioner in connection with the resolutions for the salaries authorized and actually paid to Mr. Cun-

(Testimony of Ernest S. White.)

ningham and Mr. Morse. I think that concludes the offer.

The Court: How long were you in the court room this morning?

The Witness: Oh, possibly 40 minutes.

The Court: What time did you come in?

The Witness: About around 10:00 o'clock.

The Court: Then you went out again?

The Witness: Well, maybe I was wrong there, on the time. I went out during recess, whatever time that was.

The Court: Well, I think in view of the fact that most of the testimony you seek to offer was with respect to comparable salaries in other concerns, that I probably will be willing to waive the fact that this witness was in the court room and let him testify.

Mr. McFarland: May an exception be noted?

Mr. Zeutzius: What is your occupation?

The Court: Pardon me. Be sure to watch out now that any witness you want to use is not in the court room, because we don't want this occasion to arise.

Mr. Zeutzius: Will the Court ask if there is any [121] witness for Walts, Inc., in the court room? Anybody here subpoenaed as a witness in the Walts, Inc., case now on trial?

The Court: Apparently not. Now you may proceed.

By Mr. Zeutzius:

Q. What is your occupation?

A. Foundry owner, foundry man.

Q. For how long have you been in the foundry business? A. Well, close to 20 years.

(Testimony of Ernest S. White.)

Q. At the present time what is your connection with the foundry business?

A. I am the owner.

Q. Of what? A. E. S. White Company.

Q. That is a sole proprietorship?

A. That is right.

Q. Now, during the period in question, which is roughly 1940, 1941, 1942, during your war years all through 1942, by whom were you employed?

A. By the Aluminum Company of America.

Q. And did there come a time—in what capacity?

A. Production manager.

Q. Were there many production managers in that concern? [122] A. No.

Q. What were your duties as production manager?

A. Well, I had approximately 50 employees under my direct supervision, and it was our job to take in the purchase orders, send them out throughout the plant, expediting and priorities and so on and so forth, make deliveries, see that they got proper priorities from the various government agencies and so on and so forth.

Q. What salary did you receive for that position?

A. At that time I was drawing around 350 a month.

Q. Was that raised? A. How?

Q. Was that increased at any time?

A. No, because I left there soon thereafter.

Q. Why did you leave?

A. Well, because I heard that these different

(Testimony of Ernest S. White.)

plants around town that you heard about were beginning to pay some big money, so I went out after it myself. As a matter of fact, I started Valves, Incorporated, at that time.

Q. You were originally with Valves, Incorporated?

A. Valves, Incorporated, which is now the Aluminum Casting Company.

Q. And how many stockholders were there?

A. There were six of us.

Q. Were all six of you active? [123]

A. Yes.

Q. And what salaries were paid to the six individuals?

A. Well, we set our salaries at the time at 10,000.

Q. For each of the six? A. That is right.

Q. And what were the duties of each of the six, very briefly?

A. Well, we each had a particular job to do in the plant, and I was to handle all the outside contacts, like sales, and one of the members was the office manager and accountant, and another was the plant superintendant, then there was the foundry foreman, the core room foreman and the trimming department foreman, totalling six.

Q. Each of them, his salary was fixed at \$10,000.00? A. That is right.

Q. Now, did there come a time when you were no longer with the Valves—what was that?

A. Valves Castings, Incorporated.

Q. Valves Castings, Incorporated?

A. Yes, sir.

(Testimony of Ernest S. White.)

Q. Did there come a time when you were no longer connected with them?      A. That is right.

Q. When was that?

A. The latter part of 1943. [124]

Q. Then where did you go?

A. Well, I took a vacation for myself. I had a nervous breakdown.

Q. Occasioned by what?

A. To overwork and worry and so on and so forth.

Q. Where did you go after you recuperated?

A. I swore I would never go back to the foundry business again, and I went into the furniture business and worked for Harry Gladstone out on Wilshire Boulevard.

Q. When did you next go back in the foundry business?

A. Then this Valves, Incorporated, had some trouble about their priority and going broke and so on and so forth, so they contacted me and wanted to know if I wanted to go back in it, so in February of last year I went back into the foundry business again.

Q. With what company?

A. With the Aluminum Casting Company, which was prior to that time Valves and Castings, Incorporated.

Q. Is that a corporation?

A. No, it is a company now.

Q. Now, in connection with your work at Alcoa, did that occur during 1942 and that period?

A. I don't get that.



(Testimony of Ernest S. White.)

Q. Your employment with the Aluminum Company of America, was that during the year 1942?

A. Yes, and prior to that for 11 years.

Q. Did you at that time become acquainted with Mr. Cunningham of the petitioner corporation?

A. Right.

Q. Walts, Inc.?           A. Yes.

Q. What was the occasion of your becoming acquainted with Mr. Cunningham?

A. Well, through engineering purposes and foundry practice in general. He wanted some advice, and I had met him through a mutual friend, so I would go over there once in a while and give him a hand to help him get some of these jobs through and so on and so forth.

Q. Was that in your capacity with the Aluminum Company?           A. No.

Q. Now, during that time had you occasion to contact other foundries engaged in aluminum casting work, in 1942 and thereafter?

A. Well, yes and—yes.

Q. Did you learn what were the salaries and compensations paid for such jobs as superintendent of the foundry part of a plant?           A. Yes.

Q. In this area? [126]

Mr. McFarland: If the Court please, I object to this line of questioning, because this witness is not testifying from comparative companies. We have no yardstick by which to compare whatever salary presumably he is going to testify to for this particular job. I don't think it would serve any useful purpose.

The Court: I think that if you wish to prove the

(Testimony of Ernest S. White.)

salaries that any other corporation pays you would have to show that the business was comparable to this one and that the duties of the position were at least in some respects comparable. Now, you have interrogated this witness about different compensations that he has received in different capacities, and for him to testify as to compensation paid others, why, I think it would only be useful if it be shown that the businesses were at least in some reasonable degree comparable.

By Mr. Zeutzius:

Q. Do you know something of the size of the business of the petitioner during 1942?

A. Yes.

Q. How did you acquire the knowledge?

A. Well, I used to go in there once in a while and I saw the increase in plant capacity and I thought at the time, I still think right now, it was a pretty fair-sized concern. [127]

Q. Now, you are referring to 1942, about?

A. That is right.

Q. Do you know of any other plant around town about that time that was of similar size?

A. Well, in 1942 there were about two others of about the same size.

Q. What were they?

A. The R. H. Osbrink Manufacturing Company and Aluminum Alloys.

Q. Do you know what positions, who occupied positions there which were comparable, which involved duties comparable to those performed by either of the two officers, Elmer D. Morse or Mr. Walter J. Cunningham?

(Testimony of Ernest S. White.)

A. I didn't know them all personally, as a matter of fact, I can't recall their names, but I do know that there was two in the Osbrink foundry, and there were two also in the Aluminum Castings Company, and I just recall that at that time Socal began to form at that time, Socal Foundry, and they had any number of men doing the same jobs. They had salesmen, they had production managers, foremen, and superintendents, and everything, and that is one company that grew like leaps and bounds. They really went to town.

Q. Do you know what salaries they paid with respect to the production manager they had?

A. Yes. [128]

Mr. McFarland: My objection to this question is, if the Court please, I do not believe the witness has qualified himself to give the facts of his own knowledge, that he knew what they paid. I have no objection to that if he can state the source of his knowledge, but from what he has testified so far it is obvious—

The Court: You may inquire and test him out on that, Mr. McFarland, what his source of knowledge is.

Mr. McFarland: May I do so right now?

The Court: Yes.

Mr. Zeutzius: Yes, you may do so.

Mr. McFarland: Mr. White, have you ever had occasion to examine the books of any of those companies?

The Witness: No.

(Testimony of Ernest S. White.)

Mr. McFarland: You don't know the gross sales that they would show on their books for a year?

The Witness: No.

Mr. McFarland: You don't know the number of employees that any of them had during the course of 1942, for instance?

The Witness: No.

Mr. McFarland: You had occasion, I believe you testified on direct examination, to observe, let me say the area that the plant used in its physical building, is that correct? [129]

The Witness: Yes.

Mr. McFarland: Is that the basis of your comparison?

The Witness: That is right.

Mr. McFarland: But you know nothing of the financial records or the production performances of any of those companies?

The Witness: No, sir.

Mr. McFarland: And you have not examined the books and you don't know what the salaries paid various individuals in any of those companies were?

The Witness: That is right.

Mr. McFarland: I object to the question at this time.

Mr. Zeutzius: Well, may I suggest this: My understanding was, of course, that the witness in going about the trade, I understood he—probably I didn't ask all the questions that I should have, but I think that in going about the trade, I got the impression from the witness that he had gained very definite knowledge as to what various employees were paid.

(Testimony of Ernest S. White.)

Mr. McFarland: I object to this now, if the Court please. I believe the witness should testify. We have not sworn Mr. Zeutzius.

Mr. Zeutzius: Here is what I would like to do, [130] I would like to suggest in view of counsel's objection that I am satisfied to have the entire testimony of the witness go out.

Mr. McFarland: No, I will not agree to that, if the Court please.

The Court: I sustain the objection which is now being made to his testimony about the salary and wages paid these other concerns that he is about to testify to because I think his source of information would not be sufficient.

Mr. Zeutzius: Then let me ask this question—I have nothing further in view of your Honor's ruling.

By Mr. Zeutzius:

Q. Is the salary you received, do you know whether the salary you received at Alcoa, to which you testified, was that symbolic or typical of what was paid in the industry generally out there?

Mr. McFarland: I object.

Mr. Zeutzius: That is all I am asking him, if he knows.

Mr. McFarland: I object to the question.

The Court: I will overrule that objection.

The Witness: Well, I can state my own case. May I speak freely? At the time that I was production manager with Alcoa most of those foundries had growing pains, and they were paying a big amount for superintendents and so on [131] and

(Testimony of Ernest S. White.)

so forth, and I was offered by three companies at least a thousand dollars a month to take charge of production and scheduling. I turned the three of them down because I thought they were just war babies and they were not going to last. Then also I was working for Alcoa, a corporation, at that time. I also had no thought of leaving them to go into business for myself, and I figured we would have a job there for the rest of our lives. The only gripe was that they paid too low, but they pay you month in and month out for the rest of your lives, and as a matter of fact they have a retirement plan. That is why I stayed there although I was offered a good many times what I was getting at the Alcoa plant.

Mr. Zeutzius: No further questions.

The Court: Mr. McFarland?

#### Cross-Examination

By Mr. McFarland:

Q. How many years were you with Alcoa, Mr. White?      A. About 11 years.

Q. During that time you were foundry man with them, what was your official title?

A. I started there shoveling sand in the foundry and I worked myself up to production manager of the sand and permanent molds plant.

Q. In other words, you gained a personal intimate [132] knowledge of the workings of the foundry?

A. I worked all the way through every department of the foundry, yes, many of them.

Q. And you had unique knowledge that everyone doesn't have, is that right?      A. That is right.

Q. You stayed there for how long?

(Testimony of Ernest S. White.)

A. I worked for Alcoa for around 11 years.

Q. Then you went out and you went to a company called Valves Castings, Incorporated?

A. That is right.

Q. And you say you set yourselves up—by the way, was this a partnership of six men?

A. No, it was a corporation with six men in it.

Q. Did you each own one-sixth of the stock?

A. Yes, it was a closed corporation.

Q. How much stock did each one of you own?

A. We owned 40 shares of stock.

Q. How much did you six put in to get your start?

Q. Well, we started with \$10.00 a share, \$400.00.

Q. \$10.00 a share, and each put in 46 shares?

A. No, 40 shares.

Q. You set yourselves up on the books, I believe you said, at \$10,000.00?      A. Yes. [133]

Q. Did you draw \$10,000.00?      A. No.

Q. How much at any time did you draw a year?

A. We set that salary up, we had been going, we had been in operation for about maybe six or seven months, and we set that salary of \$10,000.00 a year, but I left there just about three or four months after that salary was set.

Q. When did you organize this corporation?

A. In the latter part of 1942.

Q. The latter part of 1942?      A. Right.

Q. When did you leave the corporation?

A. The latter part of 1943.

Q. What rate of compensation did you draw or what did you take out of the company?

(Testimony of Ernest S. White.)

A. Well, we were not taking much out at that time. We were taking out a hundred dollars a week salary and expenses, at least I was, and the rest were withdrawing about a hundred dollars a week also, but most of the profits we made we put right back in the business for additional equipment, which we were sorely needing.

Q. About how much equipment? Up to the time you left Valves Castings, what was the amount of capital expenditure for equipment?

A. That would be hard to say. [134]

Q. You wouldn't know offhand?

A. No, I wouldn't know, but I could say roughly maybe 20 to 25 thousand dollars. Then, in addition—

Q. What was the business of Valve Castings? Did you make castings for airplanes and aircraft parts?

A. Yes, I think we worked 100 per cent on aircraft parts.

Q. When did the aircraft industry begin to expand greatly?

A. Well, it started to expand, I would say, three months before the war started, three or four months before the war started. You see, prior to that time Douglas was one of the biggest companies here in Los Angeles, as a matter of fact on the West Coast, outside of Boeing up there in Seattle. Northrup was still in operation, had a small, little plant, and North American was just beginning to start out, Lockheed was in operation too, but that was a small plant. As soon as the war started, everybody began to go leaps and bounds.



(Testimony of Ernest S. White.)

Q. This \$10,000.00 figure that you set up was just more or less of a mark to shoot at during the period you were with Valves, isn't that right?

A. Well, it was a mark to shoot at, yes, but we knew that we were going to make that also.

Q. You didn't know when, but you knew you were going [135] to make it?

A. Oh, yes, definitely.

Q. Then you got out of the foundry business; I believe you testified you got back in in February, 1945?

A. Yes.

Q. And you are now with the Aluminum Castings Company?

A. No, I am the owner of the E. S. White Company foundry.

Q. That is a sole proprietorship?

A. That is right.

Q. You are the sole owner of it?

A. That is right.

Mr. McFarland: I believe that is all.

### Redirect Examination

By Mr. Zeutzius:

Q. I forgot to ask, Mr. White, have you ever worked on the commission basis in the sale of these aluminum products and in the sale of foundry products for aircraft?

A. Yes.

Mr. McFarland: I object. That is not proper redirect examination.

The Court: I will overrule the objection.

By Mr. Zeutzius:

Q. When were you so employed on that basis?

A. Well, when I went back to the Aluminum

(Testimony of Ernest S. White.)

Castings Company, I went back there the early part of last year and on a salary and commission basis.

Mr. McFarland: I ask that this testimony be stricken. It obviously relates to the year 1945, and on the same basis of your Honor's ruling on the year 1943 I ask that this be stricken.

The Court: I think so. I think that would be too long after the taxable year to be of any material value.

Mr. Zeutzius: Well, I would like to ask the witness whether the compensation—

Mr. McFarland: I don't believe the questions should be leading, either.

The Court: No, be careful, do not lead the witness.

By Mr. Zeutzius:

Q. Was there any change in compensation rates between 1942 and 1945, any substantial change?

Mr. McFarland: I object, if the Court please, to that question as too general, so general that it has no merit.

The Court: I sustain that objection. If this witness testified as to what commissions were paid in 1942 or thereabouts on sales, I think it might be of some value, if you want to ask him. [137]

By Mr. Zeutzius:

Q. Do you have any knowledge of what was paid to foundry salesmen engaged in a business similar to that of the petitioner at about 1942, where the salesmen operated on a commission basis?

A. Well—

Q. Do you have any such knowledge?

(Testimony of Ernest S. White.)

A. Well, I have no true knowledge, no, but I heard, I learned—

Q. At that time?

A. At that time, that—

Mr. McFarland: Well, in view of his first answer, if the Court please, I don't believe the last half of his answer is relevant or that he is capable of expressing an opinion on it.

Mr. Zeutzius: I submit that in the trade he would go in and around and hear and learn what is going on. It is hearsay in a sense.

The Court: Well, he may answer. If he had any general information about it, he may give the Court what information he had.

The Witness: Well, I was going to say that during that time when I began getting sick I tried to get a man to take my place on the outside, a man that knew the foundry business and also had the capabilities of being able to work [138] with these purchasing agents. I tried and tried and everyone that I got in there wanted a ten per cent commission plus \$100.00 a week guarantee.

Mr. McFarland: That was in 1942 when you began to take sick, isn't that right?

The Witness: Yes.

Mr. McFarland: I ask that that be stricken, if the Court please.

The Court: Well, I do not regard the testimony as of much importance, but I will not strike it.

Mr. Zeutzius: Is it stricken?

Mr. McFarland: No.

(Testimony of Ernest S. White.)

By Mr. Zeutzius:

Q. Ten per cent of what figure, do you mean?

A. Well, some of them wanted five or ten per cent of the gross, some of them wanted five or ten per cent of the net sales.

Q. In arriving at net sales, do you know what came off?

A. Well, that is all overhead and rejections and all expenses. As a matter of fact, five or ten percent of net sales would mean five or ten per cent of net profit.

Q. From the sales?                   A. From the sales.

Q. From the business. [139]

A. From sales.

Mr. Zeutzius: No further questions.

#### Recross-Examination

By Mr. McFarland:

Q. That is from five to ten per cent of the individual salesman's particular sales?

A. Yes.

Q. In other words, if you were the individual salesman, if your net sales for the year were \$30,000.00, ten per cent would be \$3,000.00, is that right?

A. That is right.

Q. Would that be what he would want?

A. That is right.

Q. And this information just now relates to 1943, is that right?

A. Well, no, because you see I have been in this business for a good many years prior to that. This includes 1941, 1942 and 1943, up until last year as a matter of fact.

Q. And it is the same all through?

(Testimony of Ernest S. White.)

A. That is right.

Mr. McFarland: I believe that is all.

Redirect Examination

By Mr. Zeutzius:

Q. One question, as the result of counsel's question. Do you know what would be normal for the total sales of the [140] average salesman? Would it be as high as \$30,000.00?

Mr. McFarland: I object, if the Court please.

The Court: Yes, I sustain that objection.

By Mr. Zeutzius:

Q. Would \$30,000.00 represent a fair estimate of total sales during a year for a salesman?

Mr. McFarland: That is again objected to.

The Court: I hadn't understood the last question that you put as being anything more than the other question.

Mr. Zeutzius: No further questions. That is all.

Mr. McFarland: That is all.

(Witness excused.)

Mr. Zeutzius: Now, there is one further witness in a similar situation who I think will be much shorter, if I may call him. Mr. Temple. Mr. Temple, will you take the stand?

Mr. McFarland: If the Court please, I make the same objection to this witness' testimony. I believe he was likewise in the court room for some time. The same objection that I made to the prior witness' testimony I now make to this witness' testimony.

The Court: What do you expect to prove by this witness?

Mr. Zeutzius: I expect to show what he made as a salesman, I think it is, about the year 1942 or thereabouts. [141]

The Court: Well, I will receive the testimony. Whereupon,

HUBERT A. TEMPLE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Huee Temple?

A. Hubert A. Temple.

Q. What is your age, Mr. Temple?

A. 24.

Q. What is your occupation at the present time?

A. Salesman.

Q. Of what?

A. Foundry products, castings, etcetera.

Q. Aluminum castings?

A. Aluminum and magnesium.

Q. Those sales are made chiefly to what type of customers?

A. Well, they are any manufacturing facilities that would use aluminum.

Q. What was your occupation in 1941 and 1942?

A. In 1941 I was a buyer at North American. In 1942 I was a salesman for a magnesium foundry.

Q. When you say North American you mean the North American Aircraft Company here near Los Angles? A. Yes, sir.

(Testimony of Hubert A. Temple.)

Q. You were a buyer, did you say?

A. That is right. I was buying castings and patterns and merchandise of every nature.

Q. During that time did you do business with Aluminum Alloys and Alcoa and the Socal and the major foundries?      A. Yes.

Q. During 1942 did you do business on behalf of North American with the petitioner, Walts, Inc., known as Dural Alloys?      A. That is right.

Q. Did you have occasion to meet Mr. Cunningham at that time?

A. I knew Mr. Cunningham and most of the men who worked for him, I would say all of them.

Q. Had you ever been in their plant?

A. Yes, sir, that was part of my job, to inspect the facilities to see that they were capable of turning out aircraft parts, especially under the Army inspection system.

Q. What was the situation with respect to competition for the furnishing of parts by the various foundries to your company?

A. In the aluminum business there was a great deal of [143] competition. We had salesmen calling on us every day trying to sell us aluminum castings.

Q. Did you give all of them orders?

A. It was impossible to give all of them orders, because aircraft castings are a special industry, where you have to be able to make a casting to withstand the stresses of an airplane in flight.

Q. Did you find orders were actually placed with Walts, Inc., or Dural Alloys?      A. Yes, sir.

(Testimony of Hubert A. Temple.)

Q. Did you have occasion to determine the quality of the aluminum products that were furnished according to those orders?

A. No, I inspected the facilities, their machines, heat-treatment machines, everything that they had in the foundry. I didn't have to inspect the product. That goes to our inspection department where they conduct tests and learn their physical and chemical requirements.

Q. So you never inspected the products?

A. No, sir, only the equipment. That was done by the inspection department.

Q. Were those products satisfactory as far as Walts, Inc., was concerned?           A. Yes, sir.

Q. Do you know anything concerning Mr. Cunningham's [144] abilities in connection with the production of those parts?

Mr. McFarland: I object to that. The witness might tell what he knows about Mr. Cunningham's activities in the production. I think it is clearly inadmissible and incompetent now.

By Mr. Zeutzius:

Q. Do you know anything concerning Mr. Cunningham's activities in connection with the production of these parts which you purchased for North American?

A. Well, we had all of our dealings with Mr. Cunningham. He was the one that we placed the orders with and it was his responsibility to deliver them to North American, and I understood that they were delivering castings according to their promise.



(Testimony of Hubert A. Temple.)

Q. Who was the salesman?

A. All of our contacts were with Mr. Cunningham, if that is what you are getting at, in the respect of giving him orders, and when we wanted any information we called him, if we wanted information on deliveries we called him, and if we wanted information about a casting, whether a casting should be redesigned, we would call Mr. Cunningham and talk over the alloys.

Q. You changed your position from a buyer into a salesman?

A. Salesman, that is right. [145]

Q. When did that occur?

A. In June of 1942.

Q. For whom did you act as a salesman thereafter?

A. The Los Angeles Magnesium Casting Company.

Q. Do you know whether it is comparable in size to the petitioner?           A. Yes.

Q. You think they are about the same size?

A. That is right, yes.

Q. What salary did you receive from Los Angeles Magnesium Casting Company, in June, 1942, or shortly thereafter?

A. My contract was to get three per cent of the gross sales.

Q. Your gross sales?

A. That is right, which were all of the sales.

Q. You were the only salesman?

A. That is right.

(Testimony of Hubert A. Temple.)

Mr. Zeutzius: Here is a man knows very well what they were paid.

Mr. McFarland: That is probably on a hearsay foundation as most, and he has testified he doesn't know how much salaries were.

Mr. Zeutzius: Well, counsel, I submit that—well, never mind.

By Mr. Zeutzius:

Q. What basis do you have for your statement that they were considerably higher than yours?

A. Well, I have never seen a salesman yet who made more than the owners of the business. It is just a definite feeling in knowing certain things, they don't usually pay somebody three times their own salary, not when they have the risk of supporting the business. That is only common business sense.

Mr. Zeutzius: No further questions of this witness.

#### Cross-Examination

By Mr. McFarland:

Q. You say you have never seen a salesman yet who made more than the owner of a business?

A. No, sir. [149]

Q. What investigation into that particular question have you made independently, on your own?

A. Being a buyer at North American, I talked to a great deal of them. I like people and find out as much as I can about people, and it just has been my observation that a salesman is not paid

(Testimony of Hubert A. Temple.)

more than the president or directors of a going concern.

Q. Well, now, the director of a going concern, what would his compensation be?

A. It depends on the business.

Q. What would it be based upon?

A. His ability, shouldn't it?

Q. I am asking you the questions. I am trying to find out.

A. His ability, all right.

Q. When you were a buyer at North American you had talked with various salesmen from companies that were furnishing materials to North American, is that right?

A. Right.

Q. From those talks with them, did you determine that the owners were being paid in each instance more than the salesmen, is that the source of your information?

A. May I counter that with something?

Q. That is an easy question to answer yes or no, I believe. [150]

A. Well, I think you could answer it yes, then.

Q. Where did you go to school?

A. Manual Arts High School.

Q. In Los Angeles?

A. Right.

Q. From there where did you go?

A. I took a couple of courses at U. C. L. A. at nights.

Q. Specializing in any particular field?

A. Economics of the aviation industry and production management.

Q. You specialized in the economics of the aviation industry?

(Testimony of Hubert A. Temple.)

Mr. Zeutzius: Here is a man knows very well what they were paid.

Mr. McFarland: That is probably on a hearsay foundation as most, and he has testified he doesn't know how much salaries were.

Mr. Zeutzius: Well, counsel, I submit that—well, never mind.

By Mr. Zeutzius:

Q. What basis do you have for your statement that they were considerably higher than yours?

A. Well, I have never seen a salesman yet who made more than the owners of the business. It is just a definite feeling in knowing certain things, they don't usually pay somebody three times their own salary, not when they have the risk of supporting the business. That is only common business sense.

Mr. Zeutzius: No further questions of this witness.

#### Cross-Examination

By Mr. McFarland:

Q. You say you have never seen a salesman yet who made more than the owner of a business?

A. No, sir. [149]

Q. What investigation into that particular question have you made independently, on your own?

A. Being a buyer at North American, I talked to a great deal of them. I like people and find out as much as I can about people, and it just has been my observation that a salesman is not paid

(Testimony of Hubert A. Temple.)

more than the president or directors of a going concern.

Q. Well, now, the director of a going concern, what would his compensation be?

A. It depends on the business.

Q. What would it be based upon?

A. His ability, shouldn't it?

Q. I am asking you the questions. I am trying to find out.

A. His ability, all right.

Q. When you were a buyer at North American you had talked with various salesmen from companies that were furnishing materials to North American, is that right?

A. Right.

Q. From those talks with them, did you determine that the owners were being paid in each instance more than the salesmen, is that the source of your information?

A. May I counter that with something?

Q. That is an easy question to answer yes or no, I believe. [150]

A. Well, I think you could answer it yes, then.

Q. Where did you go to school?

A. Manual Arts High School.

Q. In Los Angeles?

A. Right.

Q. From there where did you go?

A. I took a couple of courses at U. C. L. A. at nights.

Q. Specializing in any particular field?

A. Economics of the aviation industry and production management.

Q. You specialized in the economics of the aviation industry?

(Testimony of Hubert A. Temple.)

A. That was the name of the course.

Q. What did you study in that connection?

A. Mainly the cost-plus system in aircraft, the post-war anticipations of the aircraft industry, the suppliers who supplied parts to the aviation industry. It was a rounded course of economics of a specific business.

Q. And that qualified you very well, did it not, for your job at North American?

A. You learn a job through practical experience, I have found.

Q. Did you apply any of the knowledge that you had gained during the course of your study at U.C.L.A. to the [151] job that you had in 1941?

A. Nothing more than the average student would know about buying castings.

Q. You didn't have any particular knowledge of the problems in the department in which you went to work, is that right, when you walked into the place?      A. Absolutely right.

Q. Have you ever seen a balance sheet of Walts, Incorporated?      A. No, sir.

Q. Have you ever seen the sales journal?

A. No, sir.

Q. Never seen any of the books of account, have you?

A. In 1941 North American, 1941 and 1942, North American required a statement from all suppliers, but at this time I do not recall the figures. I just know we got all that information.

Q. When did you go to work for the Los Angeles Company?      A. In June of 1942.

(Testimony of Hubert A. Temple.)

Q. You went to work for them as a salesman, but you also were production manager or you ran the production, I believe.      A. That is right.

Q. With the help of a small boy? [152]

A. Well, I had a boy. He was 19, out of school.

Q. How many men work for this magnesium company or did work for then in 1942?

A. At the end of 1942, as I remember, about 80.

Q. About 80. Do you know what the main portion of their business consisted of?

A. Aircraft castings.

Mr. McFarland: I believe that is all.

Mr. Zeutzius: One question, if I may, by way of direct. May I ask counsel a question? I don't know, your Honor, if I asked this witness as to whether he knew back in 1942 what was being paid other salesmen doing similar work to that of the witness.

The Court: I don't think you asked him that. You asked him what he was paid. I don't think you asked him if he knew what other salesmen were paid.

Mr. Zeutzius: I would like to ask him that question, then.

#### Redirect Examination

By Mr. Zeutzius:

Q. Do you know what other salesmen were paid at about the same time you went to the Los Angeles Magnesium?

A. In the aluminum industry they ran between

(Testimony of Hubert A. Temple.)

five and ten percent and magnesium it ran between two and three per cent. [153]

Q. Of what?           A. Gross sales.

Mr. Zeutzius: No further questions.

### Recross-Examination

By Mr. McFarland:

Q. About three per cent of the gross sales?

A. That is right.

Q. You were in magnesium?

A. That is right, sir. It is a higher-priced article and naturally the salesmen are not paid as much.

Q. I suppose it is the same in that business as in any other, you start at the bottom and work up, is that right? Is that why you started in at three per cent rather than five per cent?

A. No, I just saw possibilities there.

Q. That would more than compensate you for the lower percentage?

A. That is right, sir.

Q. The particular situation of the company, then, would have some bearing upon the percentage which you would expect the salesman to go to work for the company, wouldn't it?

A. Growth possibilities, yes.

Q. And your possibilities of growing along with the company and some day maybe run the company? [154]

A. That is right.

Q. Through stock ownership?           A. What?

Q. Through stock ownership of the company?

A. Well, ordinarily, if the stock is not listed on



(Testimony of Hubert A. Temple.)

the Exchange, it is very hard to purchase. I never gave it much thought.

Mr. McFarland: That is all.

Mr. Zeutzius: No further questions.

The Court: That is all.

(Witness excused.)

(Testimony of W. J. Cunningham.)

Mr. Zeutzius: I will put Mr. Cunningham back on now.

Whereupon,

**WALTER JAMES CUNNINGHAM**

recalled as a witness for and on behalf of the petitioner, having been previously duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Mr. Cunningham, will you resume the stand. As a result, counsel, of the resolutions that you offered, I have two questions to ask, one with reference to the January 5 resolution and one with reference to the August 28. On January 5, 1942, when the directors' meeting occurred at [155] which the salaries were fixed at \$24,000.00 per year for you and Mr. Morse, what was the business outlook for Walts, Inc., on January 5, 1942?

A. Well, very promising, and as a matter of fact, had actual orders on the books, I think, at that time, totalling 35 or 40 thousand dollars plus. That is orders, I mean, not promises, but actual orders on the books.

(Testimony of W. J. Cunningham.)

Q. Were there any commitments?

A. And commitments, yes, and a considerable backlog that, of course, did not develop until later on in the year.

Q. What do you mean by "backlog"?

A. Well, a backlog of orders, that is, while the patterns had not been made, and the patterns had to be made and they had to be proven and the price had to be proven and made before actually delivering any castings on the orders. In other words, the company had anywhere from four to five or six months' work just to prepare those castings.

Q. On August 28, 1942, on the occasion of the meeting when the salaries were raised to \$36,000.00, what was the business outlook of Walts, Inc.?

A. I believe at that time we had a backlog of around a half a million dollars of unfilled orders, probably, and had actual orders placed with the company that we had on our books.

Mr. Zeutzius: No further questions. [156]

#### Cross-Examination

By Mr. McFarland:

Q. It looked like Walts, Inc., would have a good business year in both of those years?

A. That is correct.

Q. It was getting to look as if you couldn't lose, was it not?      A. That is right.

Q. So you decided to pay yourselves more salary, I believe that is what you spoke about, something about "we agreed under the circumstances," did you say that?      A. That is true.

Q. I was just wondering, when you were con-

(Testimony of W. J. Cunningham.)

sidering as a director the salaries that you were going to pay yourself and Mr. Morse on January 5, you were considering as a director that you were going to be reimbursed to a certain extent?

A. No.

Q. That never entered your mind?

A. No.

Q. You just contributed that?

A. That is correct. That is right. Frankly, I was the one to approve of any contributions, don't you believe so?

Q. Pardon? [157]

A. I was the one to approve of any contributions going in the business.

Q. You were not a stockholder?

A. No, I was not a stockholder.

Q. You were on a salary?

A. I was on a salary, yes.

Q. I believe you testified that there was also no element of or that you did not consider part of the salary in the nature of a dividend or a distribution of profits?

A. That is correct. I was not a stockholder.

Q. I believe you had a gross profit for that year of about \$100,000.00, isn't that right?

A. Approximately so, I would say.

Q. And you paid out in salaries for that \$56,000.00? A. I believe that is the figure, yes.

Q. You had other expenses of about 19,000?

A. Well, the balance sheet is there. It can be proven.

(Testimony of W. J. Cunningham.)

Q. I think that checks with the balance sheet.

A. Well, that is approximately so.

Mr. McFarland: I believe that is all.

Mr. Zeutzius: No further questions. Now, is Mr. Stevens here? Let me call Mrs. Cunningham, please.

(Witness excused.) [158]

Whereupon,

CATHERINE S. CUNNINGHAM,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Zeutzius:

Q. Your name is Mrs. Catherine Z. Cunningham?  
A. Catherine S. Cunningham.

Q. You are the wife of Walter J. Cunningham?

A. I am.

Q. President of Walts, Incorporated?

A. I am.

Q. During 1942, Mrs. Cunningham, you were a director and vice-president of Walts, Inc.?

A. I was not a vice-president in 1942.

Mr. McFarland: This is all in the stipulation.

The Witness: Oh, in 1942, yes. I am sorry. I was. That is right.

By Mr. Zeutzius:

Q. When did you acquire your stock in the corporation—in fact, I think the stipulation shows.

Mr. McFarland: We have got it set out very fully, if the court please. [159]

(Testimony of Catherine S. Cunningham.)

By Mr. Zeutzius:

Q. And the money that was used, the \$500.00 used to purchase the stock, where did you get the money?      A. I borrowed it from my father.

Q. Now, in 1942, on January 5, do you recall a directors' meeting at which the matter of salaries of the two main officers were discussed?

A. I do.

Q. Do you also recall another meeting in August, on August 28, at which the salaries of the two active officers were fixed?      A. I do.

Q. Now, about August 14, do you recall a meeting at which the directors were authorized to be paid a \$25.00 fee for each meeting attended thereafter?

A. I do. I am not sure of the dates, but I know that it was authorized.

Q. Were you present at all of the meetings for which you received \$25.00?      A. I was.

Q. What did you do? Did you render any services? What did you do for the \$25.00 that you received?

A. Well, I discussed various things. The corporation was closely held, and Mr. Cunningham and I have always discussed business ever since we have been married, and Mr. [160] and Mrs. Morse felt the same way, and were present at all times, so we decided to have these directors' meetings once a month, at which we discussed things pro and con and tried to make suggestions, and we discussed various matters that possibly changed the course of the business.

(Testimony of Catherine S. Cunningham.)

Q. Were the other two directors, Mr. and Mrs. Morse, also present at each of those meetings?

A. Yes, they were.

Q. Did they participate in the meetings?

A. In the discussions, yes, very much so.

Q. In your opinion, in the fixing of the \$25.00 fee for attendance at each of the directors' meetings, was that a fair and reasonable compensation?

A. We thought it was at the time.

Q. Do you still think so?           A. I do.

Q. With respect to the salaries fixed for the two officers on January 5, 1942, take that one as a separate question, was it your opinion as a director at that meeting that the salary fixed for each of the two directors was fair and reasonable?

A. It was.

Q. Was it your opinion that it was fair and reasonable as it was fixed on August 28, 1942, when it was raised to the rate of \$36,000.00 a year? [161]

A. I thought that increased production and increased responsibilities warranted it, yes.

Mr. Zeutzius: You may cross-examine.

#### Cross-Examination

By Mr. McFarland:

Q. During 1941 and 1942 were you an officer of the company?

A. I was vice-president and director in 1942.

Q. And now, in that connection, in your duties as vice-president, what did you do?

A. Well, my duties were very limited. I was not very active at the time, but I was later on in the business. It was more or less secretarial work.

(Testimony of Catherine S. Cunningham.)

Q. Later on, what do you mean by "later on"?

A. Those are years that we do not discuss right now.

Q. You don't discuss right now 1941 and 1942?

A. I thought you meant in 1943. In 1941 and 1942 I was at the plant every day in the office.

Q. What did you do at the plant?

A. I did considerable typing and I helped the payroll clerk and I helped on the office work under Mr. Morse.

Q. How does the company keep its books, do you know?

A. Mr. Morse was in charge of the books at that time, and of course the auditors.

Q. Do you know how the books are kept? [162]

A. No, I don't, not at that time.

Q. You don't know whether they are kept on a cash basis or on the accrual basis?

A. I was not interested in that. Mr. Morse was in charge of that.

Q. Do you have any knowledge of the situation?

A. No, I haven't.

Q. What else did you do as vice-president?

A. That is all.

Q. You were there every day?           A. I was.

Q. How long did you spend at the plant every day?

A. About five or six or eight hours, sometimes ten, if Mr. Cunningham was working, might stay about—many times we didn't leave there until 9 o'clock at night.

(Testimony of Catherine S. Cunningham.)

Q. You were never paid any compensation for the work?           A. I was not, no.

Q. Did you ever ask for any compensation?

A. No, I didn't.

Q. You felt that the compensation would be paid your husband and he recompense you for the work you did?

A. Well, not necessarily. I was simply trying to help out.

Mr. Zeutzius: I didn't hear the answer.

The Witness: I was simply trying to help out.

By Mr. McFarland:

Q. You were interested in seeing the officials make a success, weren't you?

A. Naturally, it was my husband.

Q. How did you as a director determine the 240,000 figure that you adopted in January of 1942?

A. Well, I don't know as I recall what our conversations were about that time. That was remuneration in the first place for 1941. Mr. Cunningham had drawn nothing and we had lived on borrowed money, one reason, one thing was because I think it would have been impossible to get the money for the success of the business. It would have been entirely lost if my relatives had not always known of his ability in the past.

Q. You didn't quite answer my question. I want to know how you determined \$24,000.00 was to be the figure instead of 20,000 or 25,000.

A. Because he had been in the habit of earning that money in the past. I had always had an excellent income of 20 to 25 thousand a year.



(Testimony of Catherine S. Cunningham.)

Q. Did Mr. Cunningham, to your knowledge, invest any of his money in the business at any time?

A. In which business do you mean?

Q. This business. A. No, he didn't. [164]

Q. In this Walts, Incorporated?

A. No, he didn't.

Q. What did you do before you married Mr. Cunningham? A. I was in school.

Q. You have a family, have you not?

A. I have.

Q. And you keep a house? A. I do.

Q. You did during 1941 and 1942?

A. I did, but my children are grown and I was not in the home as much.

Q. How old were they then?

A. Well, I have a daughter 26 and one 24 and a son 18 right now.

Q. Where did you hold these directors' meetings? A. At the office.

Q. What time of the day would they be?

A. Around six o'clock as a rule, sometimes 5:30.

Q. You say you discussed the problems that arose in the business at that time?

A. Yes, we did.

Q. Well, do you recollect discussing the company's purchase of a heat-treating furnace?

A. I certainly do. [165]

Q. How much did they pay for it?

A. I can't remember what the Lindbergs—we had a full discussion of the various furnaces and decided they were the best, even though they were the highest.

(Testimony of Catherine S. Cunningham.)

Q. Did you discuss that? A. Yes.

Q. You did?

A. At that time it was very hard to get heat-treating furnaces, but it so happened that my brother-in-law, who was with Reynolds Metals, through his connections with Reynolds Metals, was able to get a Lindberg furnace for us. Otherwise they would not promise delivery.

Q. Do you know why the Lindberg furnace is best?

A. I don't know, but we have a metallurgist and his opinion was it the was the one for us.

Q. Did you talk to him?

A. I did, because I went East for that purpose.

Q. You have never drawn any salaries or any compensation for other than director's fees?

A. Up to 1942, no.

Mr. Zeutzus: You are referring to the taxable period?

Mr. McFarland: That is right.

The Witness: No.

Mr. McFarland: I think that is all. [166]

Mr. Zeutzus: No further questions. Thank you, Mrs. Cunningham. And now I believe Mrs. Cunningham can stay in the court room.

(Witness excused.)

Mr. Zeutzus: Is Mr. Stevens here? Your Honor, we have subpoenaed Mr. Elmer D. Morse, who is no longer with the company and who at best would undoubtedly be an unwilling witness. Your Honor signed the subpoena yesterday and I tried person-

ally to get him here. I talked with him on the phone and Mr. Cunningham has sought him earlier. If you deem necessary, I will be very happy to have the process server take the stand at a later time. He was here this morning. The only purpose would be to have him take the stand to show that we tried to get the man in and that is the reason why he has not testified in this case.

The Court: Well, I am willing to accept your statement that you have endeavored to get this witness by means of a subpoena to testify here, and just what effect that might have on this case I don't know, but to say the least of it, if possible failure to testify you feel should be an unfavorable factor here, it would be removed by your statement that you endeavored to get him.

Mr. Zeutzius: I have, your Honor, and this gentleman who was here this morning is the man who tried.

The Court: Yes. Well, I will assume for the [167] purposes of this hearing that you have endeavored to get the attendance of Mr. Morse as a witness.

Mr. Zeutzius: We have. I think that concludes the petitioner's case in chief.

Mr. McFarland: Respondent rests.

Mr. Zeutzius: And we therefore rest.

The Court: Very well. That concludes the hearing in the case. This is a case where it is largely one of fact, except a question of law which the petitioner says he is going to urge in the case. Now, I will call for a filing of an opening brief for the petitioner, then a reply brief by respondent and then

an answering brief by the petitioner. What time would you like to have within which to file your opening brief?

Mr. Zeutzius: Well, let's see. This is the last of June. I am going on my vacation in August, so may I ask when in the normal course we would get the transcript—45 days, I don't go until August, so I will try to get my brief in. Suppose your Honor makes it 45 days and if I get it in sooner—is that too much time?

The Court: Well, no. August 5th would be somewhat a little more, I believe, than 45 days.

Mr. Zeutzius: As I understand, we mail it to Washington?

The Court: To the clerk of the Tax Court, yes.

Mr. Zeutzius: And serve counsel here first?

The Court: Yes, you serve him with a copy.

Mr. Zeutzius: We can serve counsel here about the first of August, get it to the Tax Court in the ordinary course of mail, I suppose, in a couple of days. Make it any date that you wish to make it.

The Court: Well, I will fix August 5th, and then the respondent may have until September 5th in which to file his reply brief, and then the petitioner may have until October 5th in which to file his final answering brief.

Mr. Zeutzius: Thank you, your Honor.

(Whereupon, at 3:15 o'clock p. m., June 18, 1946, the hearing in the above-entitled matter was closed.)

[Endorsed]: T.C.U.S. Filed July 8, 1946. [169]

[Endorsed]: No. 12143. United States Court of Appeals for the Ninth Circuit. Walts, Inc., petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Petition to Review a Decision of the Tax Court of the United States.

Filed January 3, 1949.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

---

In the United States Court of Appeals  
for the Ninth Circuit

Docket No. 6974

WALTS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

AFFIDAVIT IN SUPPORT OF APPLICATION  
FOR EXTENSION OF TIME TO FILE  
RECORD ON REVIEW

County of Los Angeles,  
State of California—ss.

Geo. H. Zeutzius, being first duly sworn, deposes and says:

That he is one of the attorneys of record in the above entitled cause, and that heretofore a number of extensions of time have been granted by this Court for the filing of the record on review from

the decision of the Tax Court of the United States; that said extensions of time were granted to permit compromise proceedings having for their object the settlement not only of the above entitled cause but other claimed income tax liabilities for subsequent years; that the last of said orders was made on December 14, 1948 and extended petitioner's time to file the record on review in the above entitled Court from December 15, 1948 to January 1, 1949.

That by reason of the short extension of time thus granted counsel for petitioner immediately instituted proceedings to have the record on review transmitted by the Clerk of the Tax Court of the United States to the Clerk of the above entitled Court; that on Monday morning, December 27, 1948, counsel for petitioner received the following telegram from the Clerk of the Tax Court:

“Copy designation *Walts, Inc.* arrived December twenty fourth original may be filed to-day considerable photostating required utterly impossible to get record to Ninth Circuit January first suggest you get twenty day extension and wire us that fact.

VICTOR S. MERSCH, Clerk.

That, as appears from said telegram, the Clerk of the Tax Court requires to and including January 21, 1949 in order to transmit the record on review to the clerk of this Court.

Wherefore, affiant prays that petitioner's time

within which to file the certified record on review with the clerk of this Court be extended to January 21, 1949.

/s/ GEO. H. ZEUTZIUS.

Subscribed and sworn to before me this 27th day of December, 1948.

/s/ A. P. G. STEFFES,  
Notary Public in and for the County of Los Angeles, State of California.

Ordered time extended to January 4, 1949.

/s/ WILLIAM DENMAN,

[Endorsed]: Filed December 29, 1948. Paul P. O'Brien, Clerk.

---

[Title of U. S. Court of Appeals and Cause.]

### STATEMENT OF POINTS AND DESIGNATION OF RECORD

Pursuant to Rule 19(6) of the Rules of the United States Court of Appeals for the Ninth Circuit, petitioner files this concise statement of the points on which it intends to rely.

#### I.

Petitioner, upon the hearing of its petition for review herein, intends to rely upon all of the points specified in its "Assignment of Errors," Nos. 1 to 13, both inclusive, contained in its petition for review by this Court, filed with the Clerk of the Tax Court of the United States on July 7, 1947, which points are incorporated herein by reference.

## II.

Since, by P. L. 773, 80th Cong., amending Sec. 1141, I.R.C., effective September 1, 1948, United States Courts of Appeals have been given jurisdiction to review decisions of the Tax Court in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury, petitioner also intends to rely upon the following additional points:

(a) The Tax Court erred in entering decision for respondent.

(b) The Tax Court erred in not entering decision for petitioner.

(c) The Tax Court erred in failing to find or conclude that there were no deficiencies in declared value excess profits tax and excess profits tax due from petitioner for the calendar year 1942.

(d) The Tax Court's finding and conclusion that "a reasonable allowance for salary for the services rendered by Walter J. Cunningham and Elmer D. Morse to the petitioner \* \* \* during the year 1942 was \$10,000 per annum for each" is erroneous and without support by any substantial evidence.

(e) The Tax Court's special findings of fact do not support its ultimate findings of fact and conclusions against petitioner.

(f) The Tax Court's primary or evidentiary findings of fact are incomplete and clearly erroneous in all material respects, in the light of the uncontradicted evidence of petitioner and the fact that Judge Harlan, who decided the case, was not the trial judge and, therefore, had no opportunity what-



soever to judge the credibility of the witnesses.

(g) The Tax Court erred in failing to find and conclude that \$28,000 was a reasonable allowance for salary for services rendered by Walter J. Cunningham to petitioner for the year 1942, and in failing to make a similar finding and conclusion with respect to Elmer D. Morse.

### III.

#### DESIGNATION OF PARTS OF RECORD TO BE PRINTED

Petitioner respectfully submits that the entire record and all of the proceedings, evidence and exhibits in the case, as certified to you, and as set forth in the stipulated designation of record filed in the Tax Court on December 27, 1948, will be necessary for the consideration of the points upon which petitioner intends to rely. Accordingly, petitioner requests you to have printed the entire record on review, including this Statement and Designation and all orders entered by this Court herein since December 27, 1948, except that there should be omitted the opening statements of counsel commencing with the 18th line on page 2 of the typewritten transcript of the hearing, filed July 8, 1946, and continuing to and including line 1 at the top of page 15 thereof; and there also should be omitted from the printed record, but only in the event this Court should grant petitioner's motion that the same shall be considered by the Court in their original form as though set out in the printed record, the following exhibits and papers: Exhibit 1-A of Stipula-

tion of Facts, which exhibit consists of three letters numbering 12 pages, already described as to their contents in paragraph numbered 6 of said Stipulation; Petitioner's Exhibits 10 and 11 consisting of its 1940 income tax return, and petitioner's corporate minutes of August 14, 1942 authorizing the directors' fees which were allowed by the Tax Court; Respondent's Exhibits J, K, L, M and N, consisting of petitioner's 1941 and 1942 tax returns and petitioner's corporate minutes of March 31, 1941, referred to in paragraph numbered 7 of the Stipulation of Facts; its minutes of January 5, 1942, referred to in paragraph 11 of the Stipulation of Facts, and its minutes of August 28, 1942, already set forth almost in their entirety in paragraph numbered 15 of the Stipulation of Facts; also Respondent's Computation for Entry of Decision, together with its annexed computation, filed March 10, 1947.

Dated, January 12, 1949.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

(Affidavit of Service by Mail.)

[Endorsed]: Filed January 15, 1949. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

MOTION FOR ORDER FOR CONSIDERATION  
OF EXHIBITS IN ORIGINAL FORM

Petitioner, by its attorneys, moves the Court to enter an order that the following exhibits and papers forming part of the entire record and proceedings on review herein, certified to this Court by the Clerk of the Tax Court, shall be omitted from the printed record on review herein, and that said omitted exhibits and papers shall be considered by this Court in connection with this review in their original form as though set out in said printed record on review:

1. Exhibit 1-A, consisting of three letters described in paragraph 6 of the Stipulation of Facts;

2. Petitioner's Exhibits 10 and 11, consisting of its 1940 income tax return and petitioner's corporate minutes of August 14, 1942 authorizing the directors' fees which were allowed by the Tax Court;

3. Respondent's Exhibits J, K, L, M and N, consisting of petitioner's 1941 and 1942 tax returns and petitioner's corporate minutes of March 31, 1941, referred to in paragraph numbered 7 of the Stipulation of Facts; its minutes of January 5, 1942, referred to in paragraph 11 of the Stipulation of Facts, and its minutes of August 28, 1942, already set forth almost in their entirety in paragraph numbered 15 of the Stipulation of Facts; and

4. Respondent's Computation for Entry of De-

cision, together with its annexed computation, filed March 10, 1947.

For reasons in support of this motion, petitioner states:

The printed record will be large and costly to petitioner and the substance of the particular exhibits described above is already materially set forth in parts of the record that will be printed. The elimination of these exhibits ought to result in the elimination of at least 50 pages from the printed transcript. Their omission will not inconvenience the Court or the parties and it is, therefore, respectfully prayed that this motion be granted.

Dated, January 12, 1949.

/s/ GEO. H. ZEUTZIUS,

/s/ A. P. G. STEFFES,

Attorneys for Petitioner.

[Endorsed]: Filed February 1, 1949. Paul P. O'Brien, Clerk.

---

[Title of U. S. Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF  
ORIGINAL EXHIBITS

The above-designated petitioner on review having duly filed its motion for consideration, in their original form, of the exhibits heretofore transmitted to this Court by the Clerk of the Tax Court, and good cause therefor appearing:

It is Hereby Ordered that Exhibit 1-A of the Stipulation of Facts; Petitioner's Exhibits 10 and 11; Respondent's Exhibits J, K, L, M and N, and Respondent's Computation for Entry of Decision, together with its annexed computation, all of which exhibits were introduced in evidence before the Tax Court of the United States in the proceeding from which the present review has been taken, and heretofore transmitted to this Court in their original form and now in the files of the above-entitled proceeding on review in this Court shall be omitted from the printed record on review herein, and that said omitted exhibits, and Respondent's Computation for Entry of Decision, shall be considered by this Court in connection with this review in their original form as though set out in said printed record on review.

Dated, January 14, 1949.

/s/ WILLIAM DENMAN,  
Judge, U. S. Court of Appeals.

/s/ WILLIAM HEALY,  
Judge, U. S. Court of Appeals.

/s/ HOMER T. BONE,  
Judge, U. S. Court of Appeals.

[Endorsed]: Filed February 1, 1949. Paul P. O'Brien, Clerk.

